

# Current Strategy

- Increase share of premium 1.6 pp/year
- Protect Premium Trademark Equity
  - Defend against price erosion using promotions
  - Add value with new product and packaging characteristics
- Attack competitors' premium niches
- Capture 40% of discount growth
  - Inject trademark equity into discount brands
- Continue cost improvement efforts
- Develop retail advantage
- Create a people advantage
- Share of Premium growth and market stability paramount goals

**PM-USA**  
5YP Pres. 1/21/93 #2

2073445412

# Current Strategy Assumptions

|   |                             |
|---|-----------------------------|
| Industry Volume Decline:                              | -2.7%                       |
| Federal Excise Tax Increases:                         | \$4 - 1994<br>\$4 - 1996    |
| State Excise Tax Increases:                           | 8%                          |
| Non-DME cost increases:                               | 1% - 3.6%%                  |
| DME thous cost increases<br>as a % of price increase: | 20% Premium<br>5% Discount  |
| % of DME price promotion:                             | 75% Premium<br>95% Discount |
| Stable Price Gap:<br>Price Gap Elasticity:            | 23% {30% new gap}<br>.30    |

# Sensitivities

|                              | <b>1992-1997</b>     | <b>1997</b>     |                  |                   |
|------------------------------|----------------------|-----------------|------------------|-------------------|
|                              |                      | <b>IFO CAG%</b> | <b>PM Volume</b> | <b>PM Premium</b> |
| <b>Industry Volume</b>       | <b>-2.7% → -3.7%</b> | <b>(1.0)%</b>   | <b>(8.9)</b>     | <b>(5.3)</b>      |
| <b>FET Increases</b>         | <b>\$4 → \$6</b>     | <b>0.3%</b>     | <b>0.9</b>       | <b>2.9</b>        |
| <b>SET Increases</b>         | <b>8% → 10%</b>      | <b>0.1%</b>     | <b>0.4</b>       | <b>1.2</b>        |
| <b>Non-DME Cost Increase</b> | <b>3% → 4%</b>       | <b>(0.4)%</b>   | <b>—</b>         | <b>—</b>          |

**PM-USA**  
5YP Pres. 1/21/93 #2

2073445414

# Sensitivities

(con't)

|   | 1992-1997<br>IFO CAG% | 1997      |            |             |
|---|-----------------------|-----------|------------|-------------|
|   |                       | PM Volume | PM Premium | PM Discount |
| <b>Premium</b><br>DME Incr. as a % of<br>price inc. 20% → 22% | (0.2)%                | 0.2       | 0.4        | (0.2)       |
| <b>Discount</b><br>DME Incr. as a % of<br>price inc. 5% → 7%  | (0.1)%                | (0.1)     | (0.8)      | 0.7         |
| <b>Stable Price Gap</b><br>23% → 20%                          | (1.1)%                | (3.6)     | (9.8)      | 5.2         |
| <b>Price Gap Elasticity</b><br>.30 → .35                      | (0.6)%                | (2.6)     | (5.8)      | 3.2         |

**PM-USA**  
5YP Pres. 1/21/93 #2

2073445415

## Sensitivities of Price "Gap"

- Current forecast assumes premium/discount share stability at 23% price difference (30% under new gap)
- For every 10 percentage point increase in that gap, discount grows about 3.0 share points
- Higher income areas are less sensitive to "gap"
- Lower income areas are more sensitive to "gap"
- Some evidence of heightened sensitivity at \$16.00 carton threshold and \$2.00 pack threshold
- Elasticity may change as premium category shrinks to "core" smokers
- Elasticity may not be a function of relative gap but absolute price of premium — i.e. gap reduction by raising discount prices may not affect trends.

**PM-USA**  
FYP Pres. 2/10/93 #4

2073445416

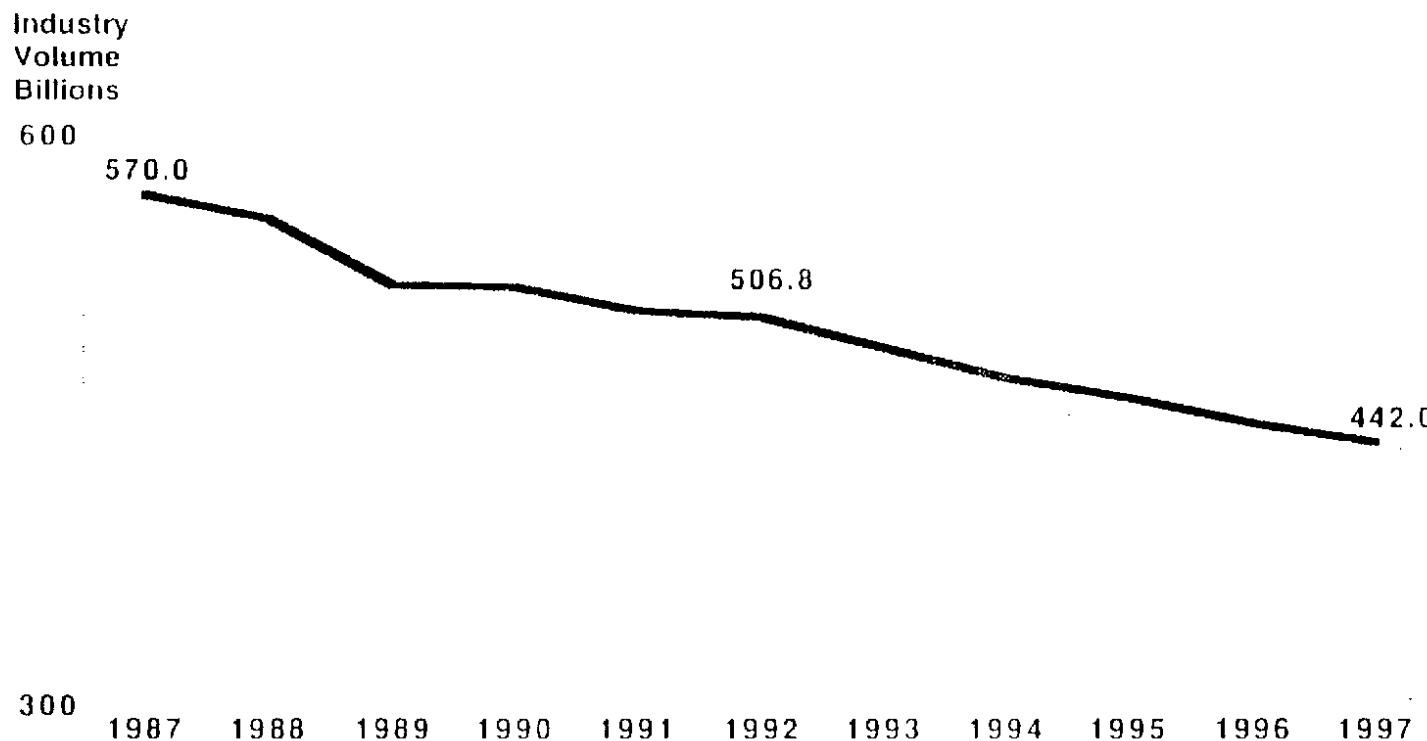
# **Factors Influencing Volume and Mix**

- **Relative Prices and Price Increases**
- **Income Growth**
- **Smoking Bans and Health Controversies**
- **Demographics**

**PM-USA**  
1993-97 FYP #3

2073445417

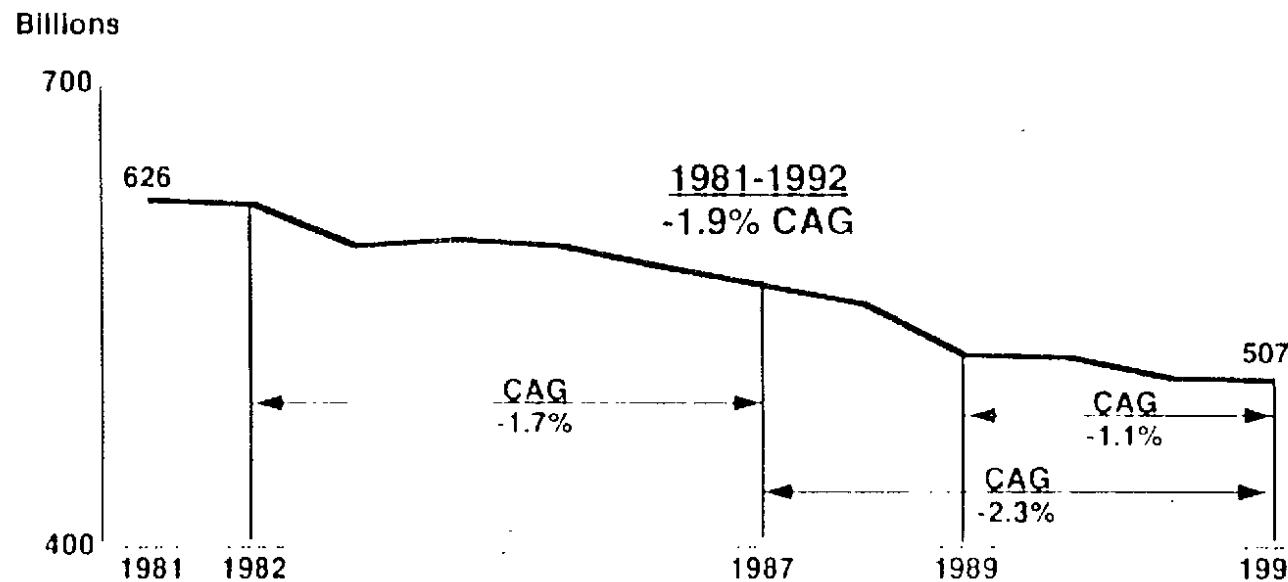
**Federal Excise taxes are expected to cause a 2.7% annual volume decline over the next five years, slightly higher than the 2.3% decline rate experienced during the previous five years.**



**PM-USA**  
1993-97 FYP Pres 2-10-93 #2

2073445418

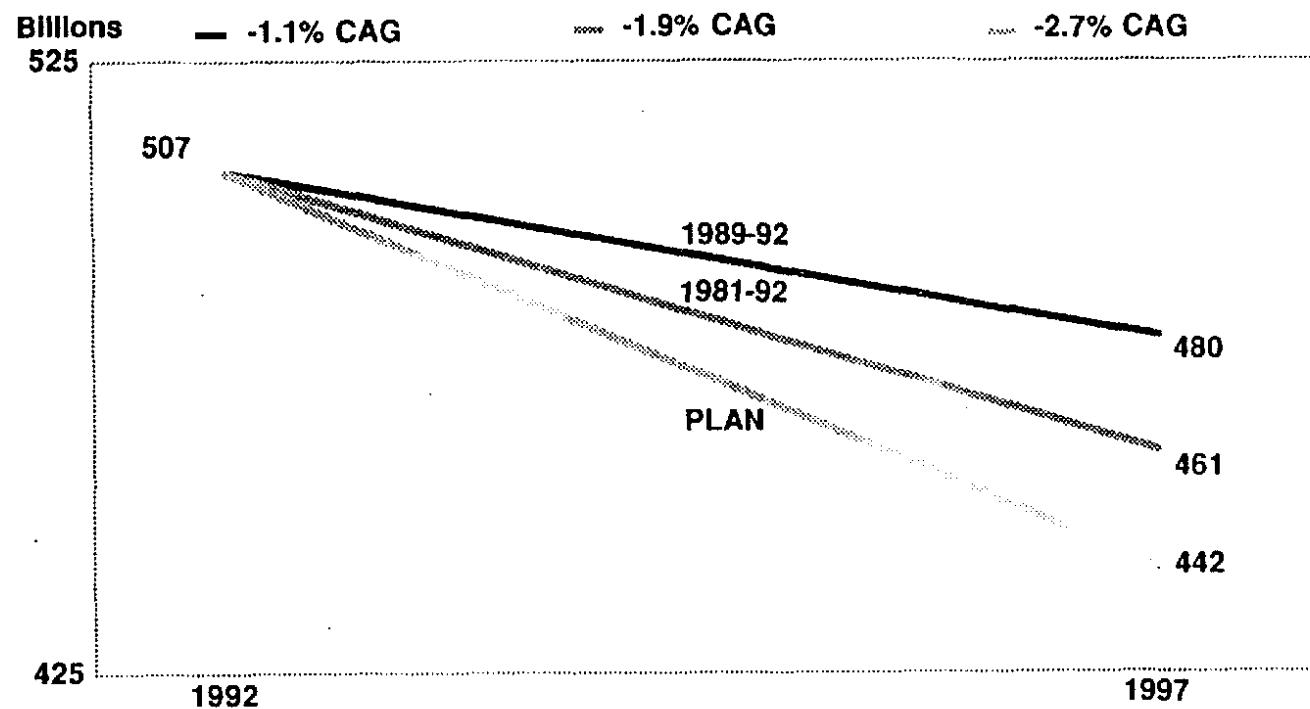
## The growth of discount has slowed annual industry volume decline to 1.1% since 1989.



**PM-USA**  
1993-97 FYP #3

2073445419

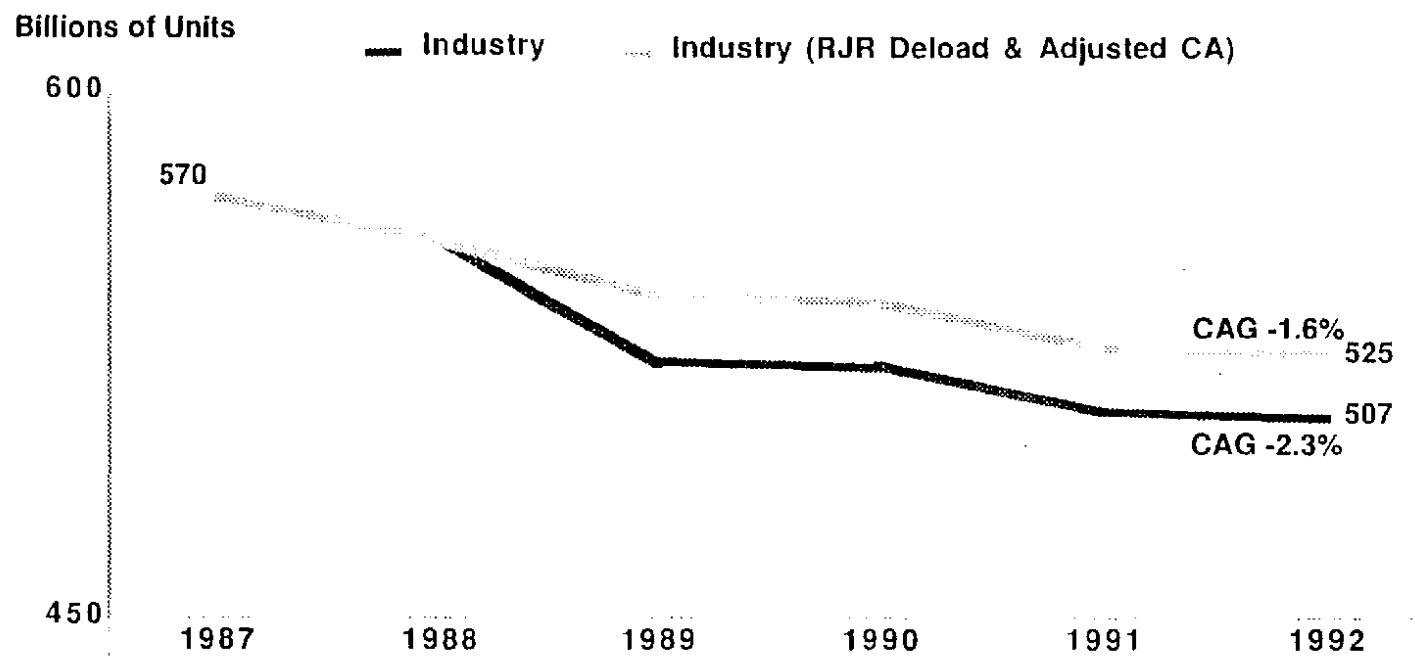
# Volume Sensitivities



**PM-USA**  
1993-97 FYP #3

2073445420

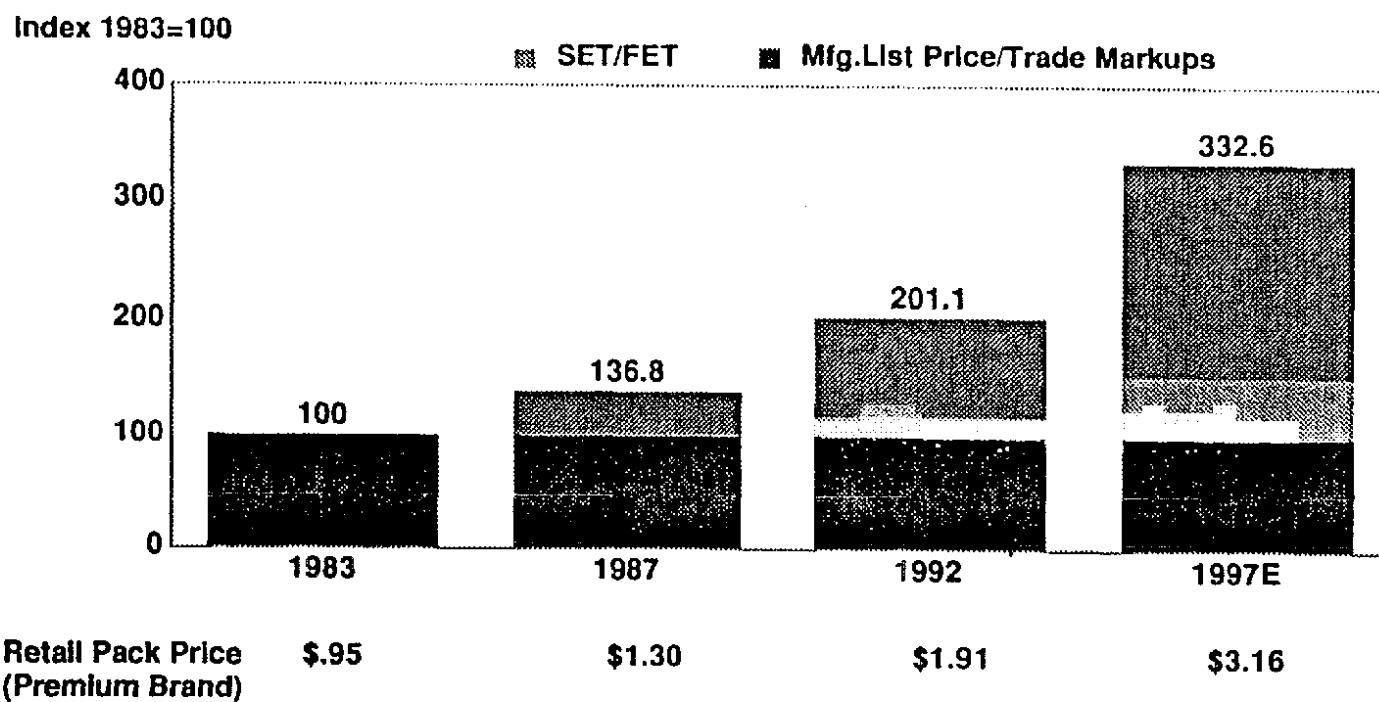
**Industry volume would have declined 1.6% annually if not for RJR's deload and California's Proposition 99.**



**PM-USA**  
1993-97 FYP Pres. 2/10/93

2073445421

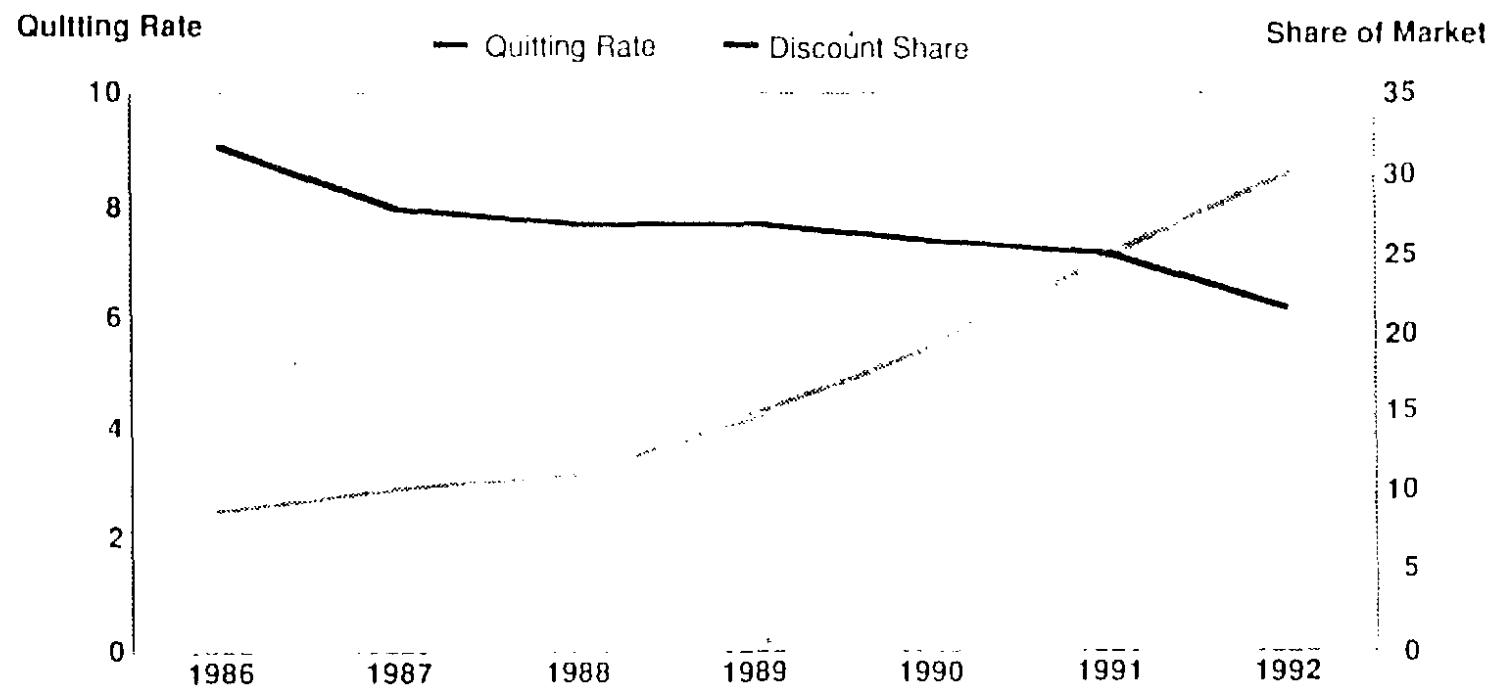
## Manufacturers' price increases will have a greater impact on the industry than excise taxes



**PM-USA**  
FYP Pres. 2/10/93 #4

2073445422

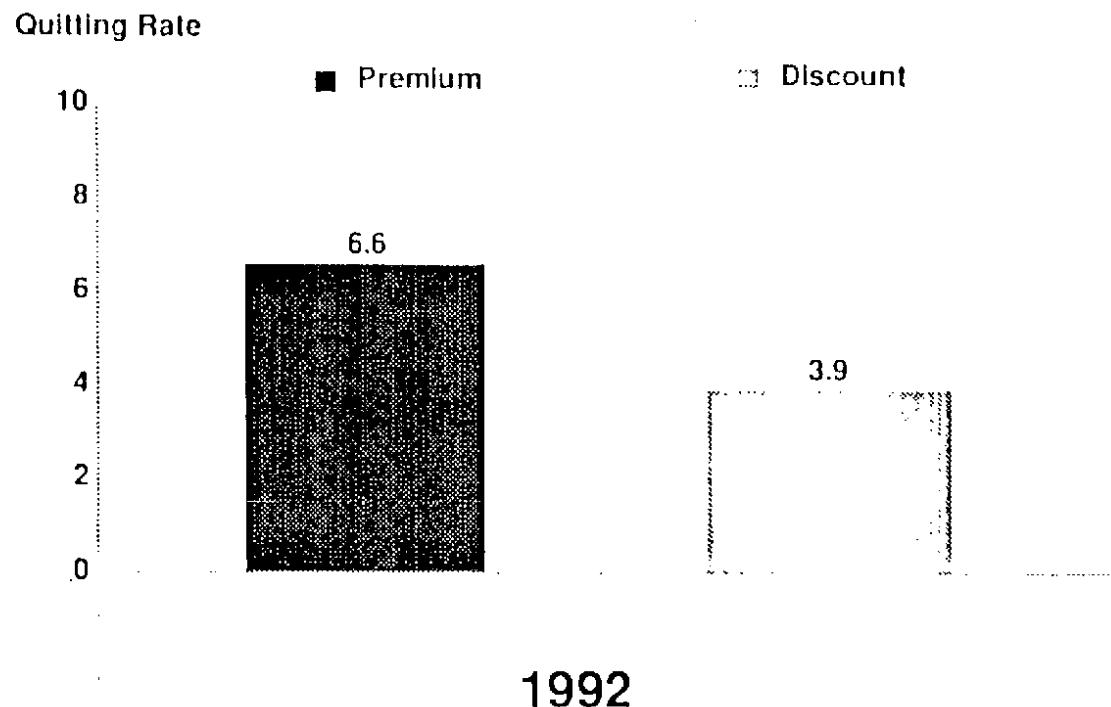
**The quitting rate has declined as  
discount's share of market has grown.**



**PM-USA**  
1993 97 FYP Pres 2/10/93

2073445423

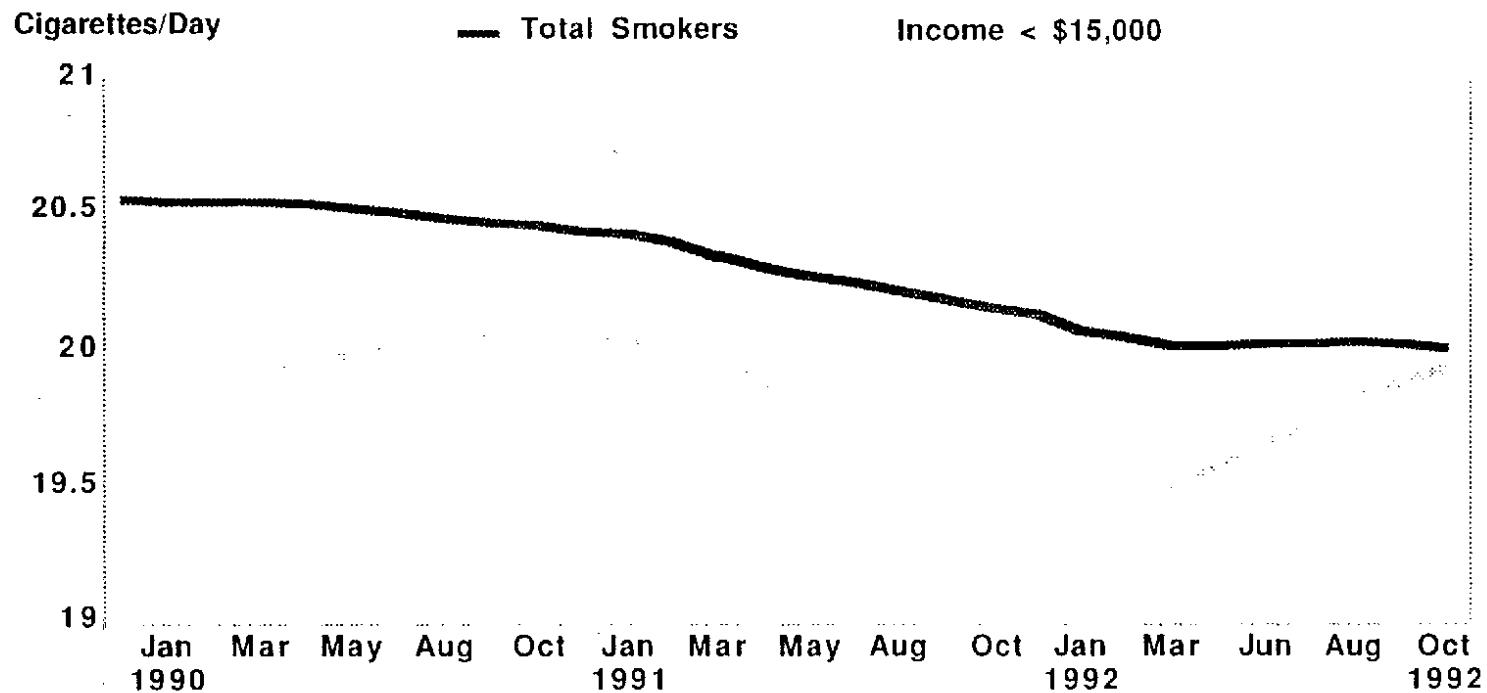
**The quitting rate among smokers of Premium brands is about 70% higher than among Discount smokers.**



**PM-USA**  
1993 97 FYP Pres 2/10/93

2073445424

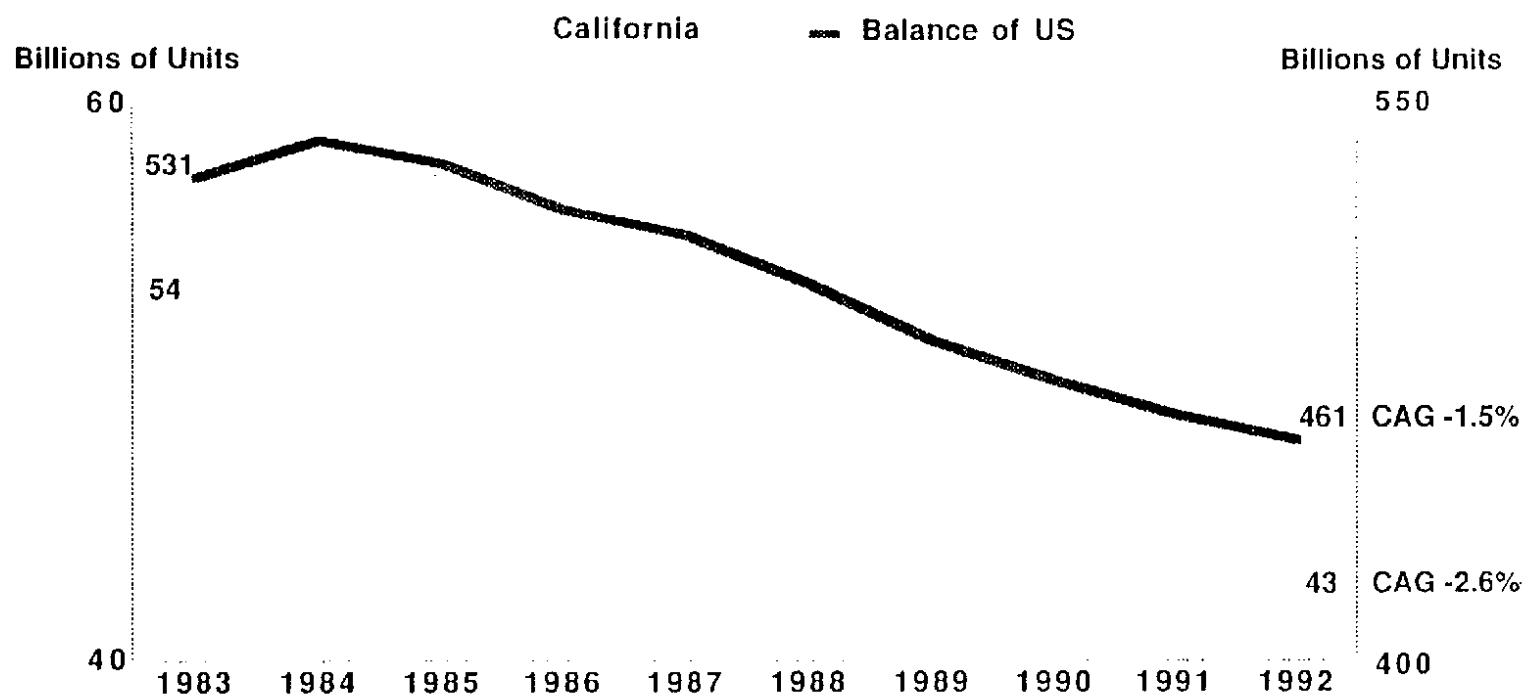
**Cigarette consumption among those with incomes under \$15,000 has increased as the growth of deep discounts has widen the price gap.**



**PM-USA**  
SYP Pres. 1/21/93 #2

2073445425

**Industry Volume in California has declined 2.6% annually since 1983. This a worst case with extremes in social pressures and taxation.**



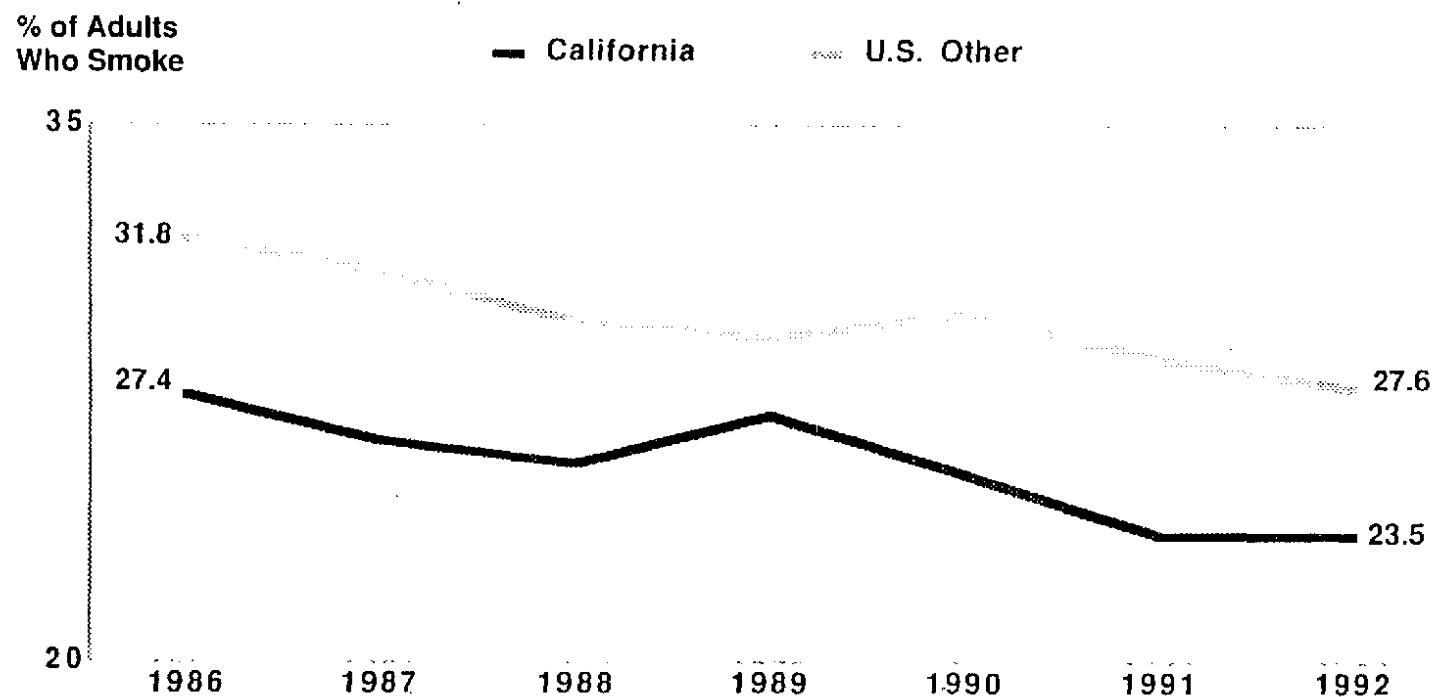
12MM load adjusted units

Note: California's 25¢ increase resulted in a 24% increase in retail pack prices.

**PM-USA**  
5YP Pres. 1/21/93 #2

2073445426

**California's Smoking Incidence remained about 4 points below national average (4.4 in 1986, 4.1 in 1992).**



**PM-USA**  
1993-97 FYP Pres 2/10/93

2073445427

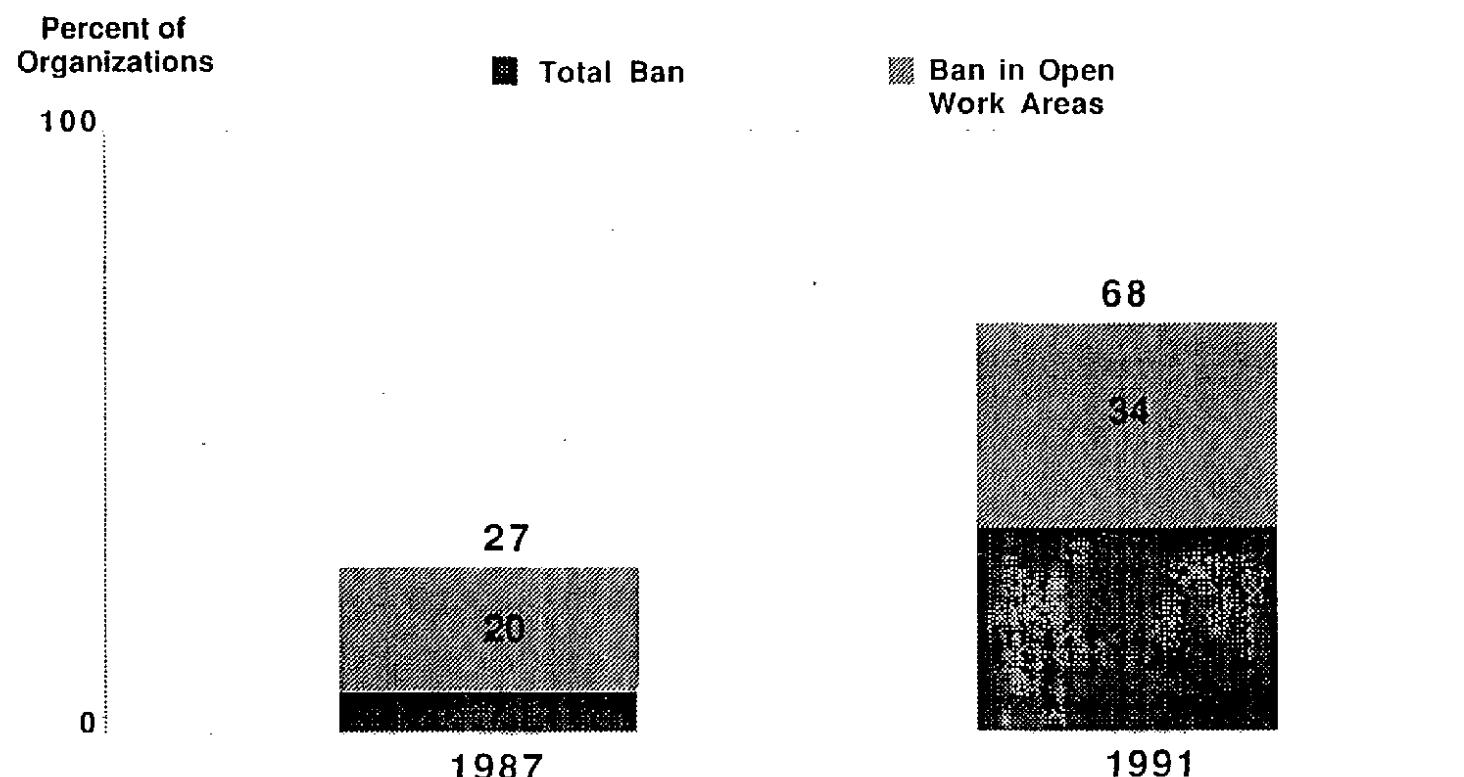
# Workplace Restrictions

- **Restrictions that accomodate smokers have little affect on consumption**
- **1988 study of a complete ban of smoking in all workplaces**
  - One time volume decline of approximately 8%
  - Quitting rate increased almost 4 percentage points

**PM-USA**  
1993-97 FYP #3

2073445428

**The prevalence of work place smoking bans has increased dramatically since 1987, yet industry volume has declined less than 2% annually (adj. for RJR de-load).**



Source: BNA Survey No. 55

**PM-USA**  
5YP Pres. 1/21/93 #2

2073445429

# PM-USA Historical Performance

|                          | <u>1982-87</u> | <u>1987-92</u> | <u>1989-92</u> | <u>Current Strategy</u> |
|--------------------------|----------------|----------------|----------------|-------------------------|
| Share of Market          | +1.00          | +.89           | +.12           | 0.0                     |
| Share of Premium         | +1.44          | +1.7           | +1.21          | +1.6                    |
| Performance Gap          | 6.5%           | 7.4%           | 5.5%           | 7.5%                    |
| Share of Discount Growth | N/A            | 31.4%          | 23.2%          | 40%                     |

**PM-USA**  
FYP Pres. 2/10/93 #4

2073445430

# Marketing Portfolio Strategy

- Protect trademark equity from price erosion
- Focus promotional spending on value gap
- Attack competitive niches with line extensions and new brands to gain incremental premium share
- Seek 40% of discount growth with branded discount product
- Focus FSF retail activity on fewer trademarks for longer periods
- Use targeted direct marketing to support other premium trademarks
- Premium share growth and market stability are paramount goals

**PM-USA**

## Current Strategy

|                        | <u>1992</u> | <u>1997</u> | <u>CAG</u> |
|------------------------|-------------|-------------|------------|
| <b>Industry Volume</b> | 506.8       | 442.0       | -2.7%      |
| <b>Premium</b>         | 353.7       | 220.1       | -9.1%      |
| <b>Discount</b>        | 153.1       | 221.9       | +7.7%      |
| <b>Discount Share</b>  | 30.2%       | 50.2%       |            |
| <br>                   |             |             |            |
| <b>PM-USA Volume</b>   | 214.3       | 194.3       | -1.9%      |
| <b>Premium</b>         | 172.8       | 125.3       | -6.2%      |
| <b>Discount</b>        | 41.5        | 69.0        | +10.7%     |

**PM-USA**  
1993-97 FYP Pres 2/10/93 #2

2073445432

## De-Loading Assumptions

|                                  | <u>1993</u> | <u>1994</u> | <u>1995</u> | <u>1996</u> | <u>1997</u> |
|----------------------------------|-------------|-------------|-------------|-------------|-------------|
| <b>Load Reduction</b>            | -1.5        | -2.0        | -2.5        | 0           | 0           |
| <b>Canadian Volume</b>           | 1.5         | 2.0         | 2.5         | 3.0         | 3.5         |
| <b>Impact on Reported Volume</b> | 0           | 0           | 0           | +3.0        | +3.5        |

**PM-USA**  
1993-97 FYP #3

2073445433

## Current Strategy Total Volume

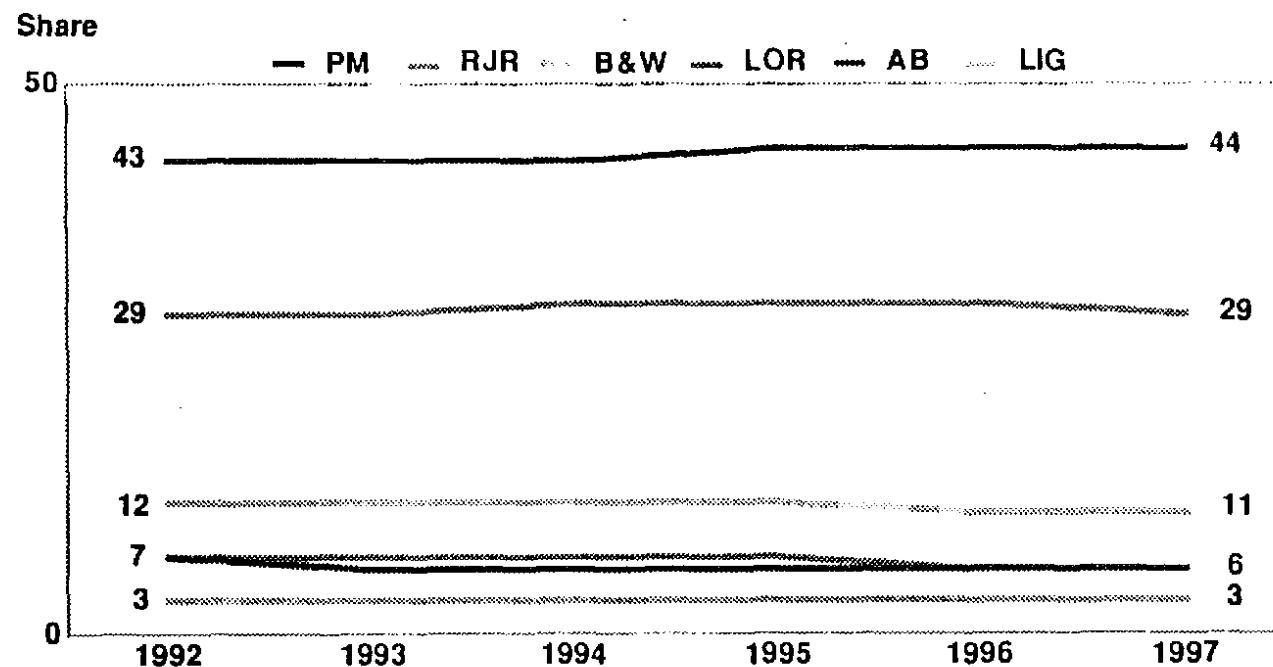
|             | <u>1987</u> | <u>1992</u> | <u>87-92<br/>CAG</u> | <u>1997</u> | <u>92-97<br/>CAG</u> |
|-------------|-------------|-------------|----------------------|-------------|----------------------|
| PM-USA      | 215.6       | 214.3       | -0.1%                | 194.3       | -1.9%                |
| RJR         | 185.3       | 146.2       | -4.6                 | 128.4       | -2.6                 |
| B&W         | 62.7        | 60.2        | -0.8                 | 50.5        | -3.5                 |
| Lorillard   | 46.7        | 36.5        | -4.8                 | 25.3        | -7.1                 |
| American    | 39.3        | 34.3        | -2.7                 | 28.4        | -3.7                 |
| Liggett     | 20.4        | 15.2        | -5.7                 | 14.6        | +0.8                 |
| <hr/> Total | <hr/> 570.0 | <hr/> 506.8 | <hr/> -2.3%          | <hr/> 442.0 | <hr/> -2.7%          |

**PM-USA**  
1993-97 FYP Pres 2/10/93 #2

2073445434

# Total Market Share

## Current Strategy



**PM-USA**  
1993-97 FYP #5

2073445435

## Current Strategy Premium Volume

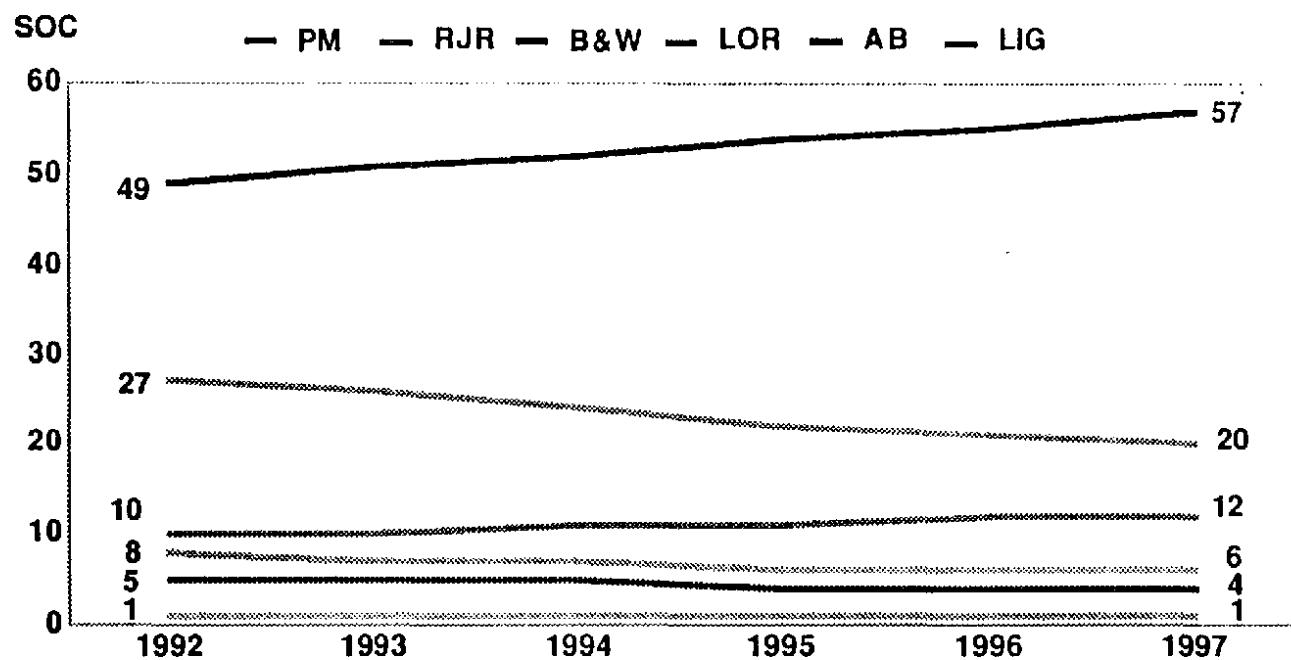
|             | <u>1987</u> | <u>1992</u> | <u>87-92<br/>CAG</u> | <u>1997</u> | <u>92-97<br/>CAG</u> |
|-------------|-------------|-------------|----------------------|-------------|----------------------|
| PM-USA      | 206.6       | 172.8       | -3.5%                | 125.3       | -6.2%                |
| RJR         | 163.1       | 95.4        | -10.2                | 43.8        | -14.4                |
| B&W         | 49.6        | 26.7        | -11.7                | 12.3        | -14.4                |
| Lorillard   | 46.7        | 35.0        | -5.6                 | 23.8        | -7.4                 |
| American    | 37.9        | 19.0        | -12.9                | 11.5        | -9.6                 |
| Liggett     | 7.8         | 4.7         | -9.6                 | 2.9         | -9.2                 |
| <hr/> Total | <hr/> 511.7 | <hr/> 353.7 | <hr/> -7.1%          | <hr/> 220.1 | <hr/> -9.1%          |

**PM-USA**  
1993-97 FYP Pres. 2/10/93 #2

2073445436

# Share of Premium

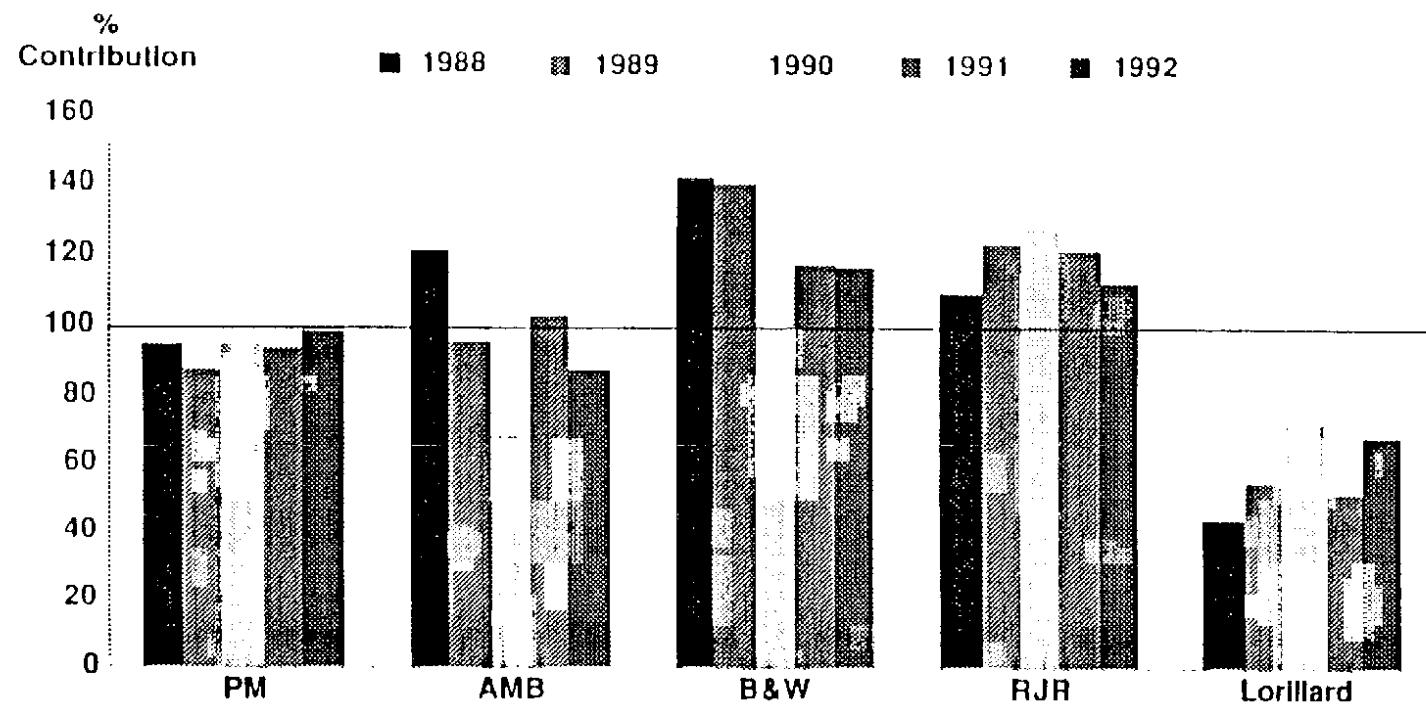
## Current Strategy



**PM-USA**  
1993-97 FYP #5

2073445437

**The rate of PM-USA's premium smokers switching to discount is below RJR and B&W, but above Lorillard and now above AMB.**



**PM-USA**  
FYP Pres. 2/10/93 #4

2073445438

## Premium Volume Impact of Socio-Demographic Losses and New Smoker Gains (1992-1997).

|   | <u>PM</u>    | <u>RJR</u>  | <u>B&amp;W</u> | <u>AMB</u>  | <u>LOR</u>  |
|---|--------------|-------------|----------------|-------------|-------------|
| <b>Socio-demo Losses</b>                        | -31.5        | -24.7       | -6.5           | -7.1        | -7.4        |
| <b>New Smoker Volume</b>                        | <u>+25.1</u> | <u>+5.1</u> | <u>+0.6</u>    | <u>+0.1</u> | <u>+5.4</u> |
| <b>Net Premium Loss<br/>(billions of units)</b> | -6.4         | -19.6       | -5.9           | -7.0        | -2.0        |
| <b>CAG %</b>                                    | <b>-0.8</b>  | <b>-4.5</b> | <b>-4.9</b>    | <b>-8.8</b> | <b>-1.2</b> |

**PM-USA**  
1993-97 FYP Pres. 2/10/93 #2

2073445439

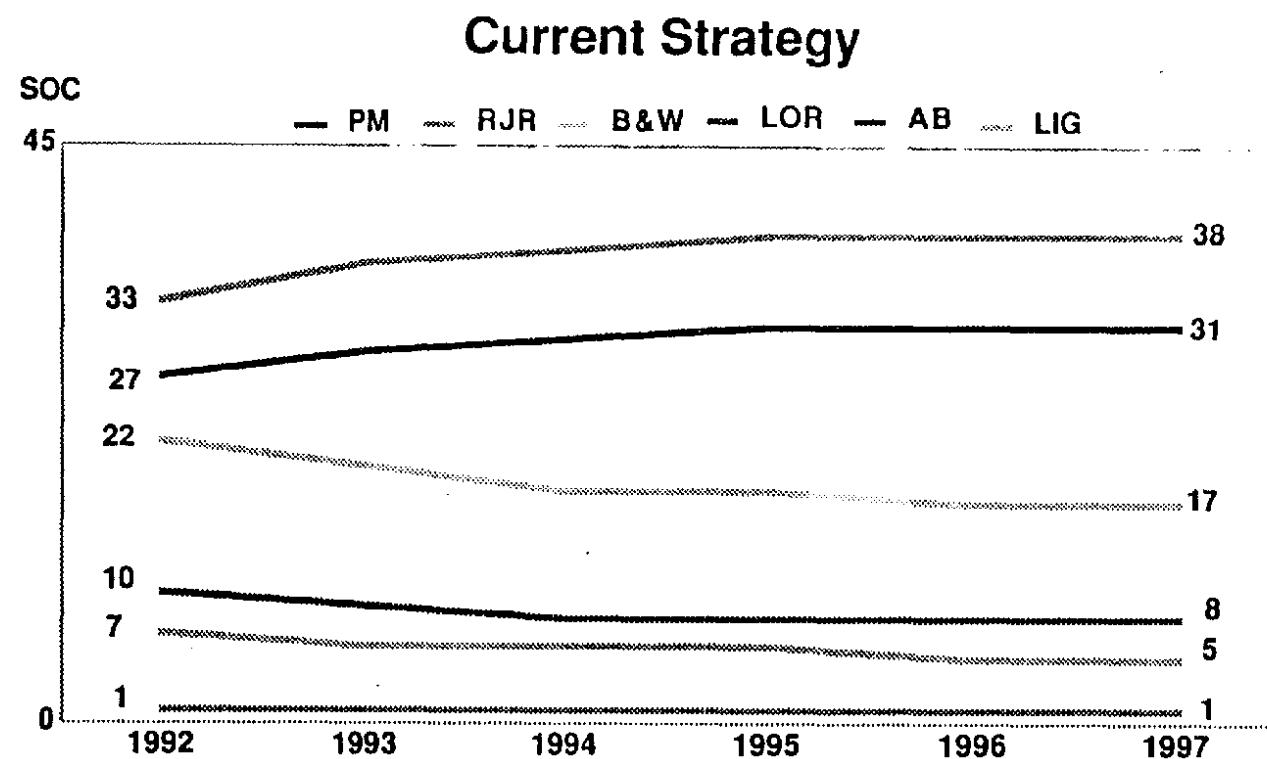
## Current Strategy Discount Volume

|              | <u>1987</u> | <u>1992</u>  | <u>87-92<br/>CAG</u> | <u>1997</u>  | <u>92-97<br/>CAG</u> |
|--------------|-------------|--------------|----------------------|--------------|----------------------|
| PM-USA       | 9.0         | 41.5         | +35.7%               | 69.0         | +10.7%               |
| RJR          | 22.2        | 50.8         | +18.0                | 84.6         | +10.7                |
| B&W          | 13.1        | 33.5         | +20.6                | 38.2         | +2.7                 |
| Lorillard    | 0.0         | 1.5          | N/A                  | 1.5          | +0.0                 |
| American     | 1.4         | 15.3         | +61.3                | 16.9         | +2.0                 |
| Liggett      | 12.6        | 10.5         | -3.8                 | 11.7         | +2.2                 |
| <b>Total</b> | <b>58.3</b> | <b>153.1</b> | <b>+21.3%</b>        | <b>221.9</b> | <b>+7.7%</b>         |

**PM-USA**  
1993-97 FYP Pres 2/10/93 #2

2073445440

# Share of Discount



**PM-USA**  
1993-97 FYP #5

2073445441

# Current Strategy

## Assumptions:

PM SOP +1.6%

PM SOD Growth 40%

|      | Price Increase |           | Effective<br>Retail Price |           |         |
|------|----------------|-----------|---------------------------|-----------|---------|
|      | Prem/BD        | Deep Disc | Premium                   | Deep Disc | New Gap |
| 1992 | \$6.00         | (\$3.65)  | \$1.91                    | \$1.05    | 82.3%   |
| 1993 | \$6.00         | \$6.00    | \$2.21                    | \$1.32    | 67.5%   |
| 1994 | \$5.25         | \$4.75    | \$2.50                    | \$1.60    | 56.1%   |
| 1995 | \$5.75         | \$5.25    | \$2.67                    | \$1.78    | 50.5%   |
| 1996 | \$6.25         | \$5.75    | \$2.96                    | \$2.09    | 42.0%   |
| 1997 | \$6.75         | \$6.25    | \$3.16                    | \$2.29    | 38.0%   |

**PM-USA**

FYP Pres. 1/21/93

2073445442

## Current Strategy Profitability

|              | <u>1987</u>    | <u>1992</u>    | <u>87-92<br/>CAG</u> | <u>1997</u>     | <u>92-97<br/>CAG</u> |
|--------------|----------------|----------------|----------------------|-----------------|----------------------|
| PM-USA       | \$2,714        | \$5,185        | +13.8%               | \$7,481         | +7.6%                |
| RJR          | 1,582          | 2,149          | +6.3                 | 3,073           | +7.8                 |
| B&W          | 516            | 660            | +5.0                 | 1,123           | +11.2                |
| Lorillard    | 502            | 870            | +11.6                | 1,099           | +4.8                 |
| American     | 430            | 536            | +4.5                 | 613             | +2.7                 |
| Liggett      | 57             | 50             | -2.6                 | 269             | +40.0                |
| <b>Total</b> | <b>\$5,801</b> | <b>\$9,450</b> | <b>+10.2%</b>        | <b>\$13,658</b> | <b>+7.7%</b>         |

**PM-USA**  
1993-97 FYP Pres 2/10/93 #2

2073445443

## Current Strategy

### Income From Operations

|           | <u>PM-USA</u> | Total<br>Industry | Industry<br>%Change | PM-USA Share of Industry |        |
|-----------|---------------|-------------------|---------------------|--------------------------|--------|
| 1992      | 5185          | 9450              | 4.5%                | 55.7%                    | 100.0% |
| 1993      | 5655          | 10175             | 7.7%                | 55.6%                    | 64.8%  |
| 1994      | 6102          | 10937             | 7.5%                | 55.8%                    | 50.8%  |
| 1995      | 6526          | 11788             | 7.8%                | 55.4%                    | 49.8%  |
| 1996      | 6991          | 12709             | 7.8%                | 55.0%                    | 50.5%  |
| 1997      | 7481          | 13658             | 7.5%                | 54.8%                    | 51.6%  |
| CAG 92-97 | 7.6%          | 7.7%              |                     |                          |        |

**PM-USA**

FYP Pres. 1 21/93

2073445444

# PM-USA Income Statement (\$/M)

## Current Strategy

|  | <u>1992</u> | <u>1997 *</u> | <u>92-97 CAG</u> |
|--|-------------|---------------|------------------|
| <b>PM-USA Volume<br/>(Incl. Military/OS)</b> | 215.5       | 195.6         | -1.9%            |
| <b>Sales (net FET)</b>                       | \$45.73     | \$66.44       | +7.8%            |
| <b>Variable Cost (net FET)</b>               | \$7.34      | \$8.74        | +3.6%            |
| <b>Marginal Contribution</b>                 | \$37.76     | \$56.97       | +8.6%            |
| <b>Fixed Manufacturing</b>                   | \$2.32      | \$2.45        | +1.1%            |
| <b>Marketing Expense</b>                     | \$10.46     | \$15.92       | +8.7%            |
| <b>R&amp;D, G&amp;A, Other</b>               | \$0.92      | \$0.45        | -13.2%           |
| <b>IFO</b>                                   | \$24.06     | \$38.16       | +9.7%            |

\* 1997 Includes Duty Free Military and revised manufacturing contract agreement with PMI. **PM-USA**  
FYP Pres. 2/10/93 #4

2073445445

## PM-USA Cash Flow (\$ Millions) Plan Projections

|   | <u>1992</u> | <u>1993</u> | <u>1994</u> | <u>1995</u> | <u>1996</u> | <u>1997</u> | <u>CUM.</u>   |
|---|-------------|-------------|-------------|-------------|-------------|-------------|---------------|
| <b>1992-96</b>                              | <b>2821</b> | <b>3407</b> | <b>3968</b> | <b>4481</b> | <b>5063</b> | <b>—</b>    | <b>19,741</b> |
| <b>1993-97</b><br><b>(Current Strategy)</b> | <b>—</b>    | <b>3407</b> | <b>3973</b> | <b>4284</b> | <b>4397</b> | <b>4710</b> | <b>20,771</b> |

2073445446

**PM-USA**  
FYP Pres. 2/10/93 #4

# **Sales Objectives**

- **Support Marketing Initiatives**
- **Optimize Retail Execution**
  - Retail Masters
- **Localize Decision Making**
  - Responsive to Market Conditions
- **Develop a People Advantage**
  - Recruitment & Training
- **Be a First Tier Supplier**
  - Retail Partnership

**PM-USA**  
1993-97 FYP #3

2073445447

# **Research and Development Objectives**

- Execute new product plan
- Develop new product technologies
- Respond to legal/regulatory changes
- Continuous cost improvement

**PM-USA**  
1993-97 FYP #3

2073445448

# **Research and Development**

- **Socially Responsive Products**
  - Sidestream smoke
  - Ingredient Reduction
  - Alternative smoking articles
- **Packaging/Flavorings**
  - Distinctive flavor systems
  - Booklet/Aluminum pack
- **Regulatory**
  - Ignition propensity
  - Ingredient reduction and labeling
- **Cost/Quality**
  - New expanded tobacco (NET)
  - Reduced cost blends and flavor systems for Discount

**PM-USA**  
1993-97 FYP #3

2073445449

# **Human Resources Objectives**

- **Ongoing Work Force Analysis and Productivity Improvement**
- **Effective Leadership and Organizational Development**
- **Diversity Management**

**PM-USA**  
1993-97 FYP #3

2073445450

# **Effective Leadership & Organizational Development**

- Break away from functional management and move toward process management.
- Aggressively pursue cross-functional development.
- Implement "Management of Change" throughout the organization.

**PM-USA**  
1993-97 FYP #3

2073445451

# **Diversity Management**

- Formalize mentoring program for minorities.
- Provide training and counseling on diverse work force.
- Monitor and report PM-USA's compliance with government mandates.

**PM-USA**  
1993-97 FYP #3

2073445452

## Risks to Current Plan

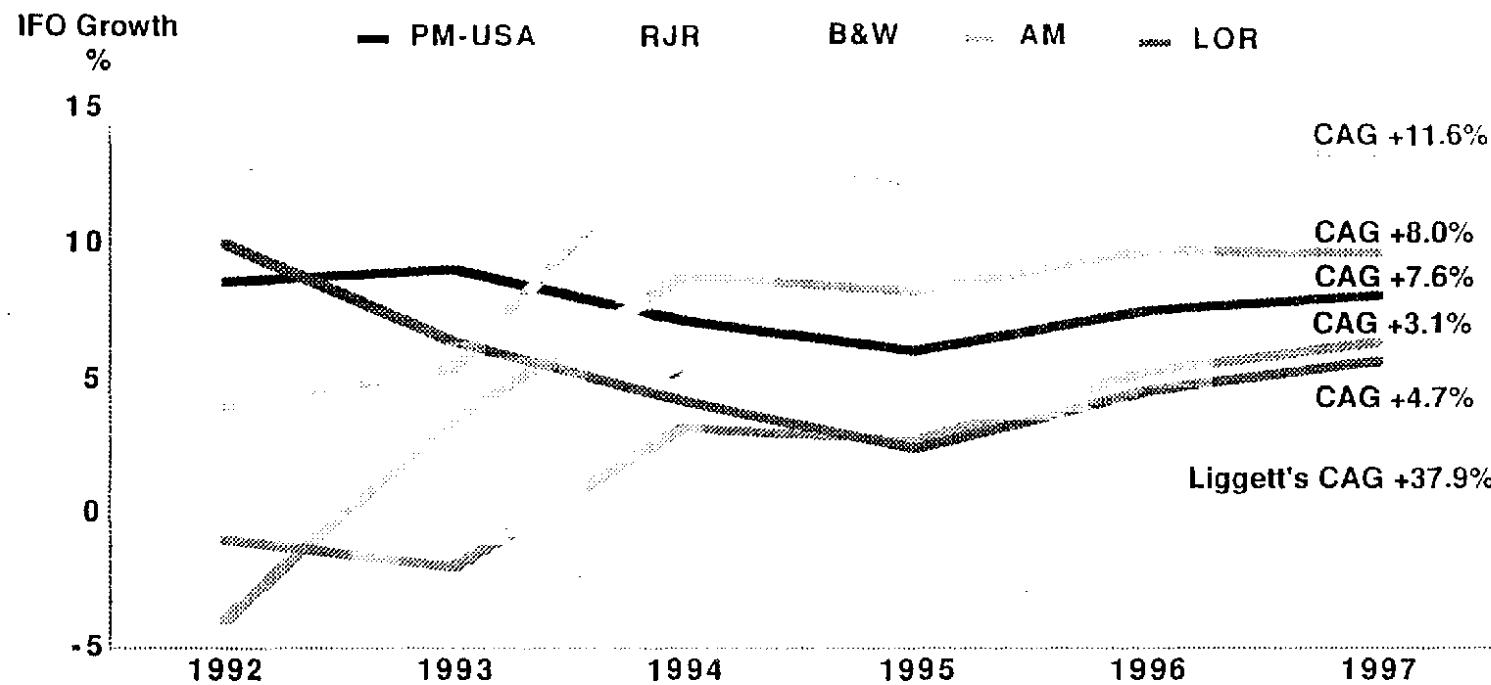
- Competitors IFO growth inconsistent with historical performance.
- Competitors' acceptance of volume and share declines inconsistent with prior years.
- Major change in market place trends of previous four years.
- Sustainability of unprecedeted margins (at low and high ends) and price increases well above consumer income growth.
- Dynamic price tiers are a market change analogous to filters, low tar or 100's.

**PM-USA**  
SYP Pres. 1/21/93 #2

2073445453

# Current Strategy

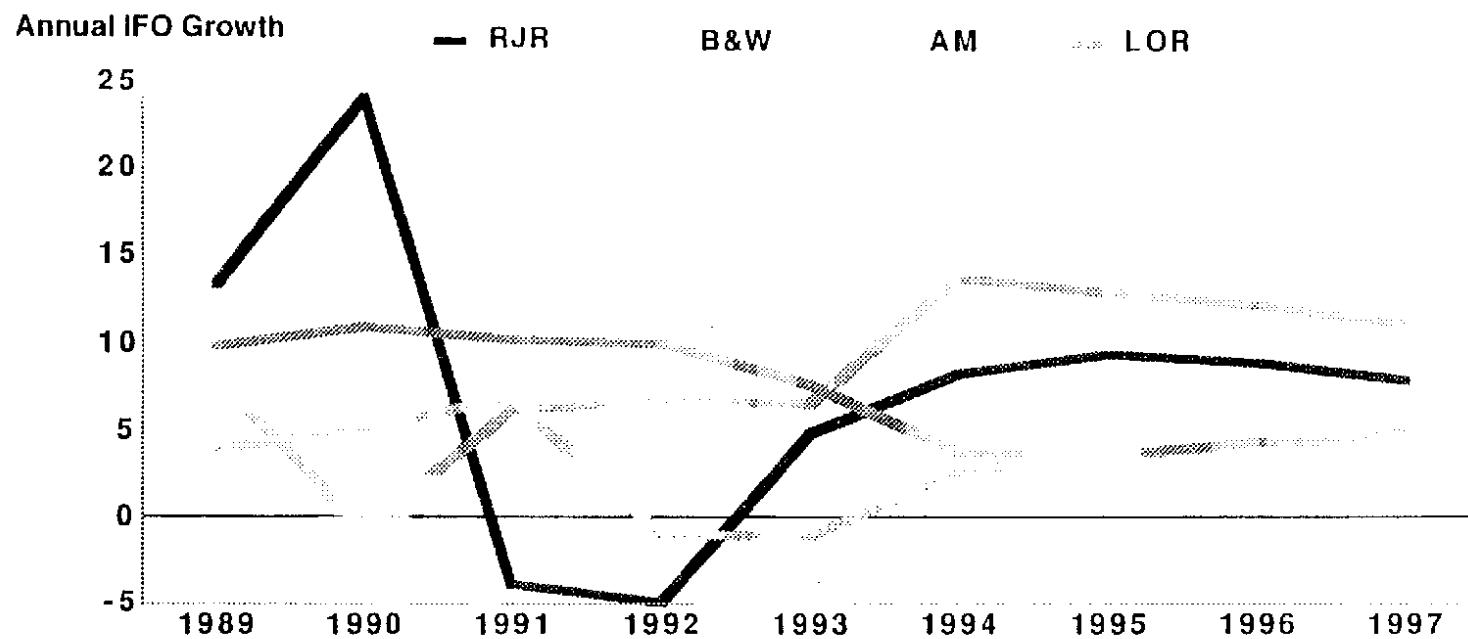
## Annual IFO Growth



**PM-USA**  
1993-97 FYP Pres. 2/10/93

2073445454

## Under the Current Strategy B&W Will Significantly Exceed Its Historical IFO Growth.



2073445455

**PM-USA**  
1993-97 FYP Pres. 2/10/93

**RJR and B&W will grow IFO faster in the next five years than in the previous five years.**

|                | <b>CAG</b><br><u>1987-92</u> | <b>CAG</b><br><u>1992-97</u> |
|----------------|------------------------------|------------------------------|
| <b>RJR</b>     | <b>5.9%</b>                  | <b>8.0%</b>                  |
| <b>B&amp;W</b> | <b>5.0%</b>                  | <b>11.6%</b>                 |
| <b>AMB</b>     | <b>4.5%</b>                  | <b>3.1%</b>                  |
| <b>LOR</b>     | <b>11.1%</b>                 | <b>4.7%</b>                  |
| <b>LIG</b>     | <b>0.8%</b>                  | <b>37.9%</b>                 |

**PM-USA**  
1993-97 FYP #5

2073445456

## PM-USA Pricing Needs and Competitors' IFO Changes in Current Strategy

|           | 1992 IFO | IFO Growth<br>% | 1993 Volume | Income Per M<br>Needed by PM |
|-----------|----------|-----------------|-------------|------------------------------|
| PMUSA     | \$5,185  | 9%              | \$467       | 211.5                        |
| RJR       | \$2,149  | 15%             | \$316       | 143.0                        |
| B&W       | \$660    | 19%             | \$125       | 56.7                         |
| AMB       | \$536    | 13%             | \$69        | 31.4                         |
| Lorillard | \$870    | 8%              | \$73        | 32.9                         |
| Liggett   | \$50     | 65%             | \$33        | 14.8                         |

**PM-USA**  
FYP Pres. 2/10/93 #4

2073445457

**Under the current plan, a new bottom price tier is likely to emerge in 1994.**

**\$/M, excluding FET**

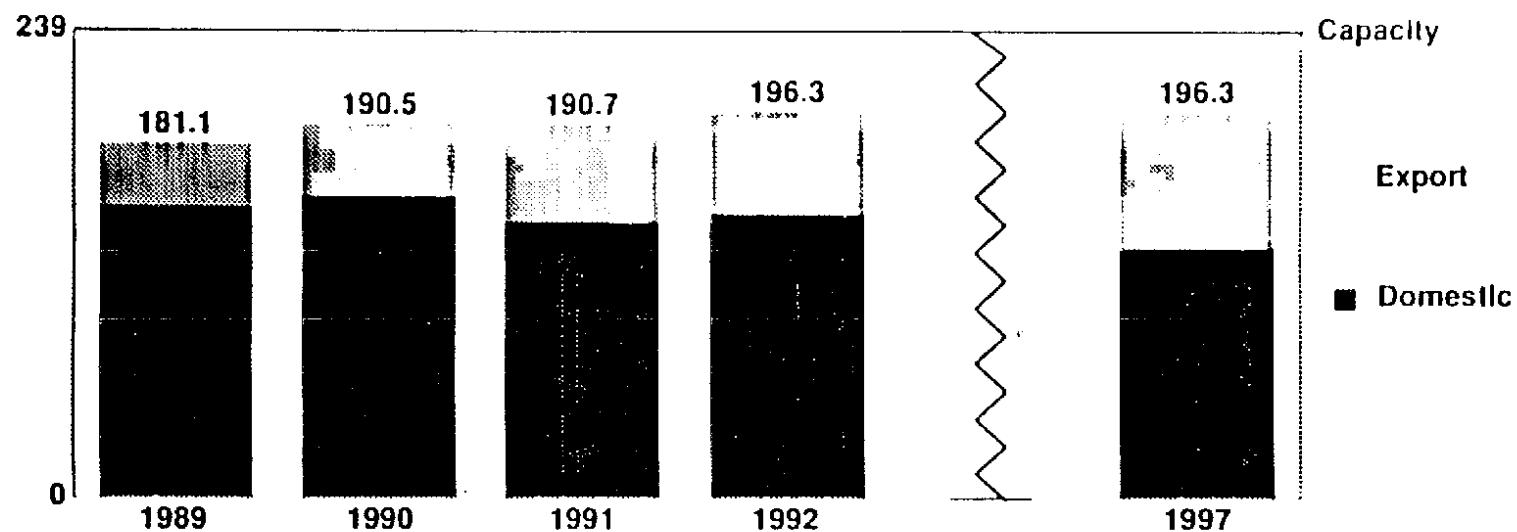
|          | <u>Premium</u> | <u>Branded Generic</u> | <u>Sub-Generic</u> | <u>Black &amp; White</u> | <u>New Tier</u> |
|----------|----------------|------------------------|--------------------|--------------------------|-----------------|
| 6/82     |                | 18.60                  |                    |                          |                 |
| 1/85     | 27.12          | 14.75                  |                    |                          |                 |
| 1/89     | 39.60          | 27.50                  | 17.75              |                          |                 |
| 6/91     | 53.25          | 45.35                  | 31.10              | 19.00                    |                 |
| today    | 59.10          | —                      | 39.45              | 20.70                    |                 |
| late '94 | 70.10          | —                      | 50.45              | 30.70                    | 19.00           |

**PM-USA**  
1993-97 FYP #5

2073445458

To maintain present capacity utilization, RJR will need to increase exports by 18 billion units, or 36%.

### RJR Cigarette Output

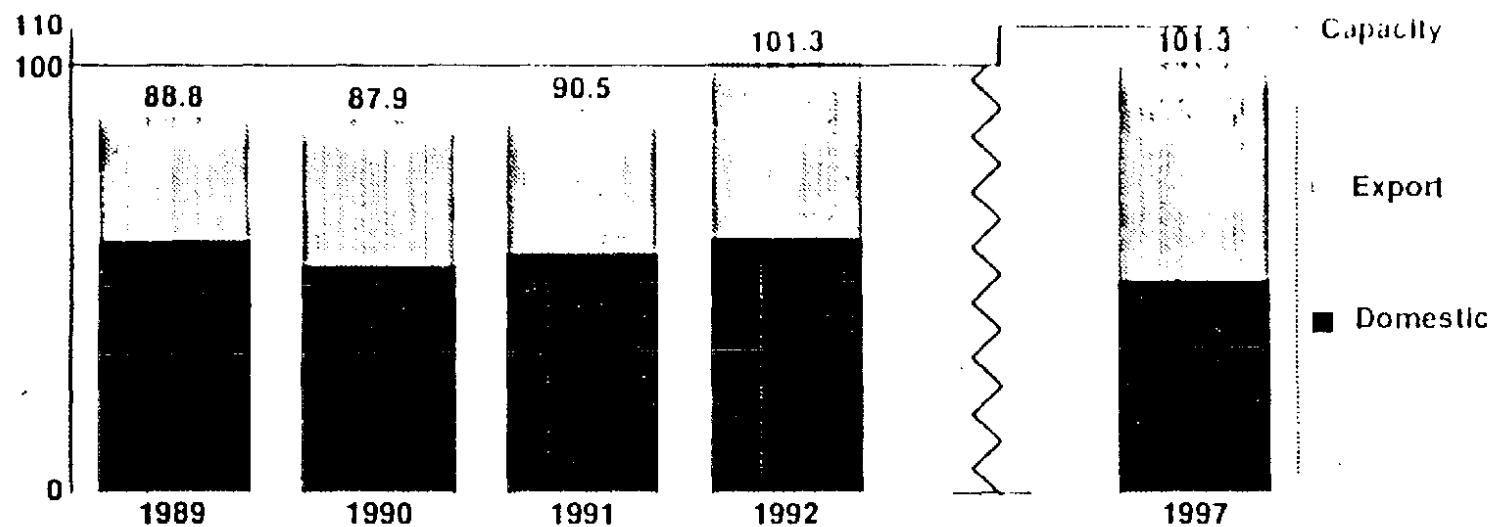


**PM-USA**  
1993-97 FYP #5

2073445459

To maintain current operating capacity, B&W will need to increase exports by 10 billion units, or 24%.

### B&W Cigarette Output

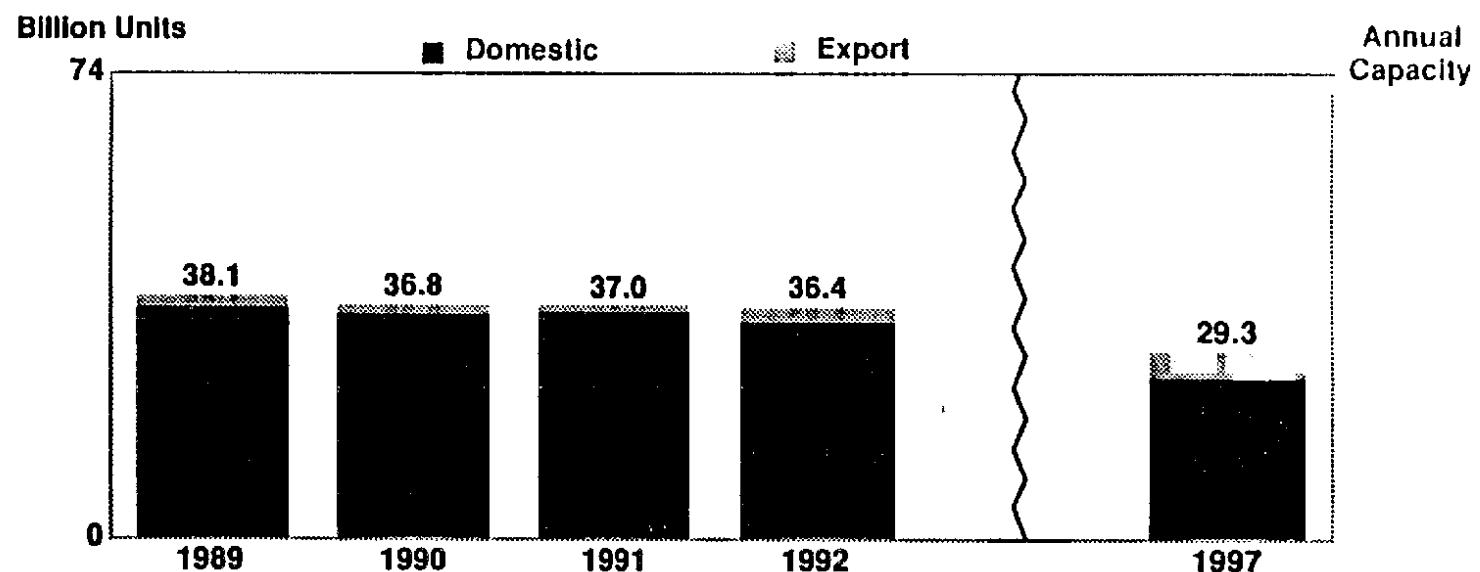


**PM-USA**  
1993-97 FYP #5

2073445460

**American Brands does not have sufficient export volume to maintain production capacity during the Plan Period.**

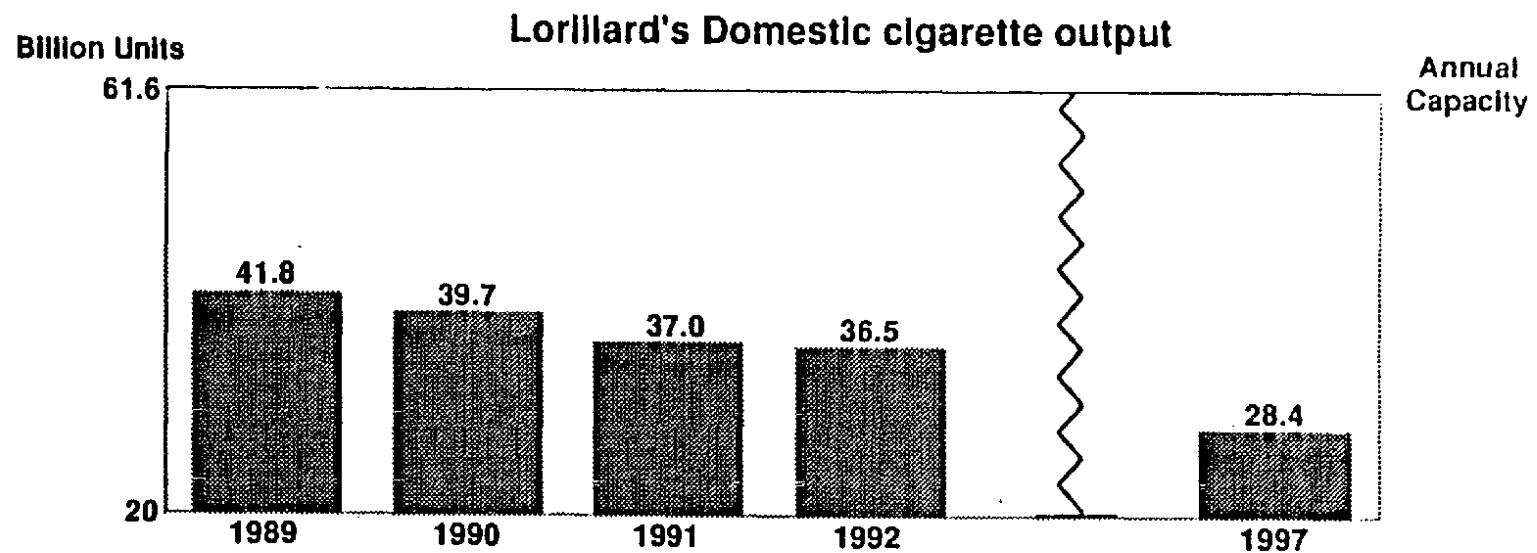
**American Brands cigarette output**



**PM-USA**  
1993-97 FYP #5

2073445461

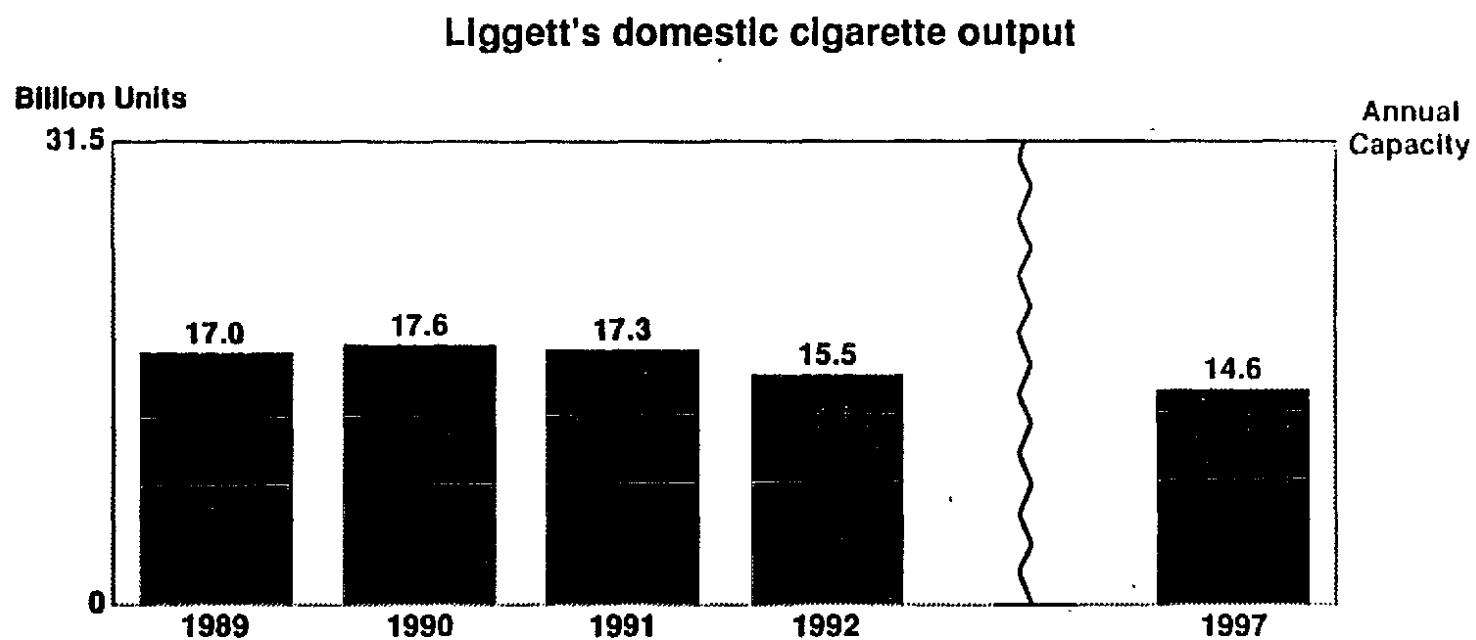
**Lorillard, with no export volume, will see its capacity utilization rate fall from 59% in 1992 to 46% by 1997.**



**PM-USA**  
1993-97 FYP #5

2073445462

**Liggett should maintain their current capacity utilization rate throughout the plan.**

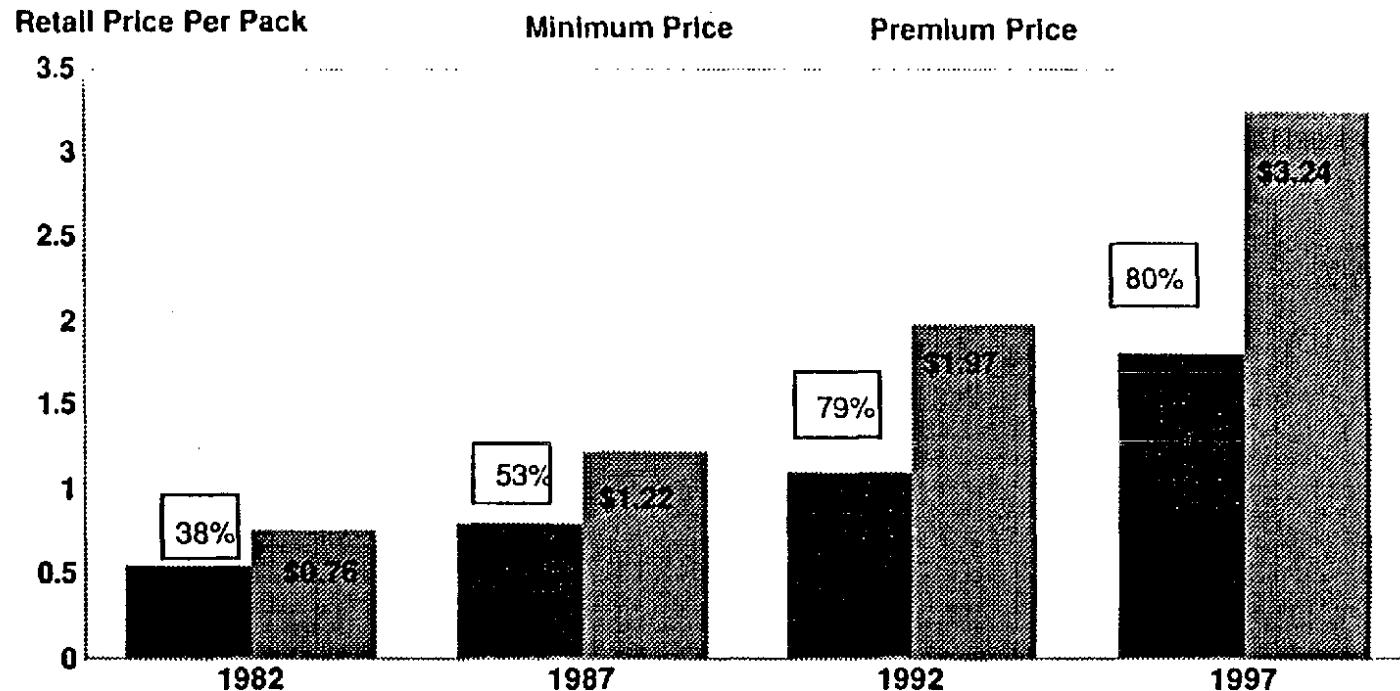


**PM-USA**  
1993-97 FYP #5

2073445463

## Current Strategy

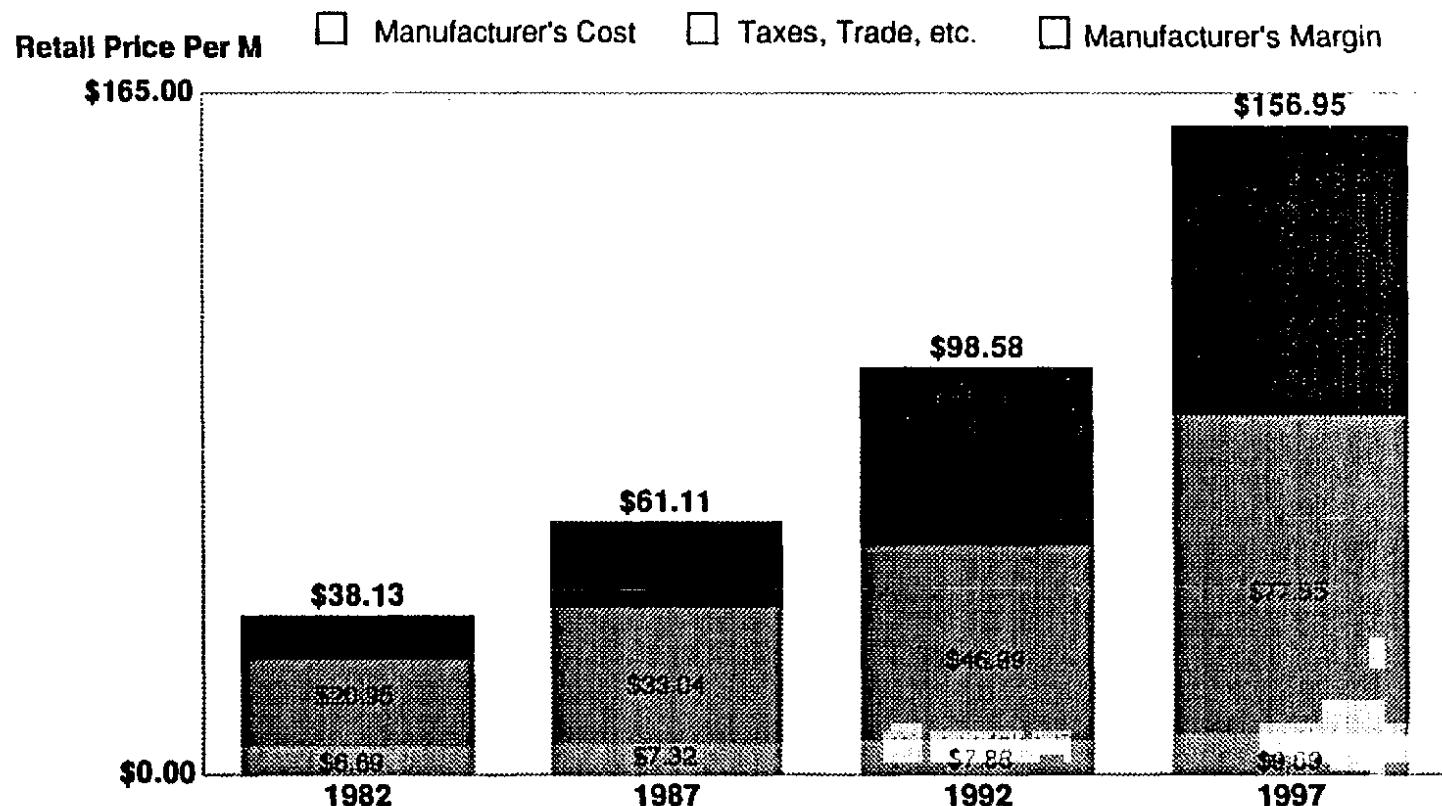
**The price gap between premium and lowest legal price will continue to grow during the plan period (new gap)**



**PM-USA**  
FYP Pres. 2/10/93 #4

2073445464

## Manufacturer margin is growing -- approaching 50% of Retail price by end of plan period



(Note: 10% of taxes, trade, etc. in 1992 is \$8 of new FETs)

**PM-USA**  
FYP Pres. 2/10/93 #4

2073445465

## **Manufacturer margin increases will continue to have a significant impact on retail premium price increases**

|  | <u>1982</u> | <u>1987</u> | <u>1992</u> | <u>1997</u> |
|--|-------------|-------------|-------------|-------------|
| <b>% Change In Manufacturer Margin</b> | 10%         | 10%         | 10%         | 10%         |
| <b>% Change In Retail Price</b>        | 3.6%        | 4.4%        | 5.8%        | 5.8%        |

**(Assumes Trade Markup/Sales Tax Multiplier of 30%)**

**PM-USA**  
FYP Pres. 2/10/93 #4

2073445466

## Future Price increases will need to grow much larger just to offset loss of premium units

|   | <u>1982</u> | <u>1987</u> | <u>1992</u> | <u>1997</u> |
|---|-------------|-------------|-------------|-------------|
| <b>Premium Volume Loss Units</b>              | 10 billion  | 10 billion  | 10 billion  | 10 billion  |
| <b>Margin per M (\$)</b>                      | \$10.49     | \$20.75     | \$43.71     | \$69.91     |
| <b>Loss In \$Millions</b>                     | \$105       | \$208       | \$437       | \$699       |
| <b>Total Premium Volume Remaining (Units)</b> | 204.4       | 206.5       | 172.8       | 125.3       |
| <b>Price Increase Offset (\$ per M)</b>       | \$.50       | \$1.00      | \$2.50      | \$5.58      |

**PM-USA**  
FYP Pres. 2/10/93 #4

2073445467

## **Premium retail cigarette prices will continue to outgrow disposable income**

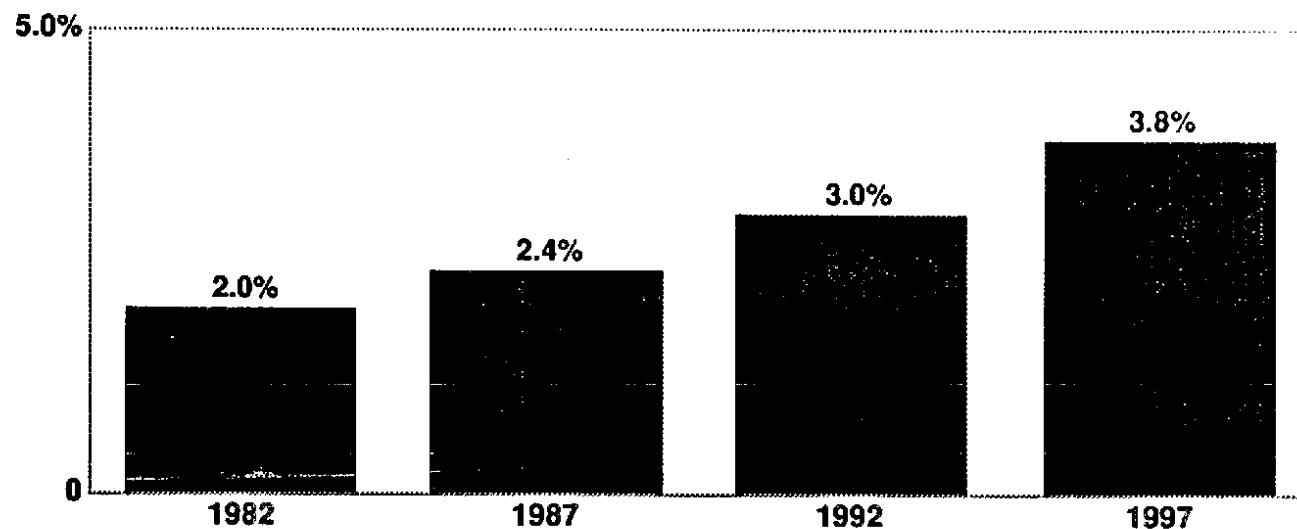
|                        | <u>1982-87</u> | <u>1987-92</u> | <u>1992-97</u> |
|------------------------|----------------|----------------|----------------|
| <b>Cigarette Price</b> | +60.3%         | +61.3%         | +59.2%         |
| <b>DPI</b>             | +33.3%         | +28.3%         | +29.4%         |
| <b>Growth Ratio</b>    | 1.81           | 2.17           | 2.01           |

**PM-USA**  
FYP Pres. 2/10/93 #4

2073445468

## Premium Prices as a % of Disposable Personal Income will continue to grow.

Premium price as a % of disposable income

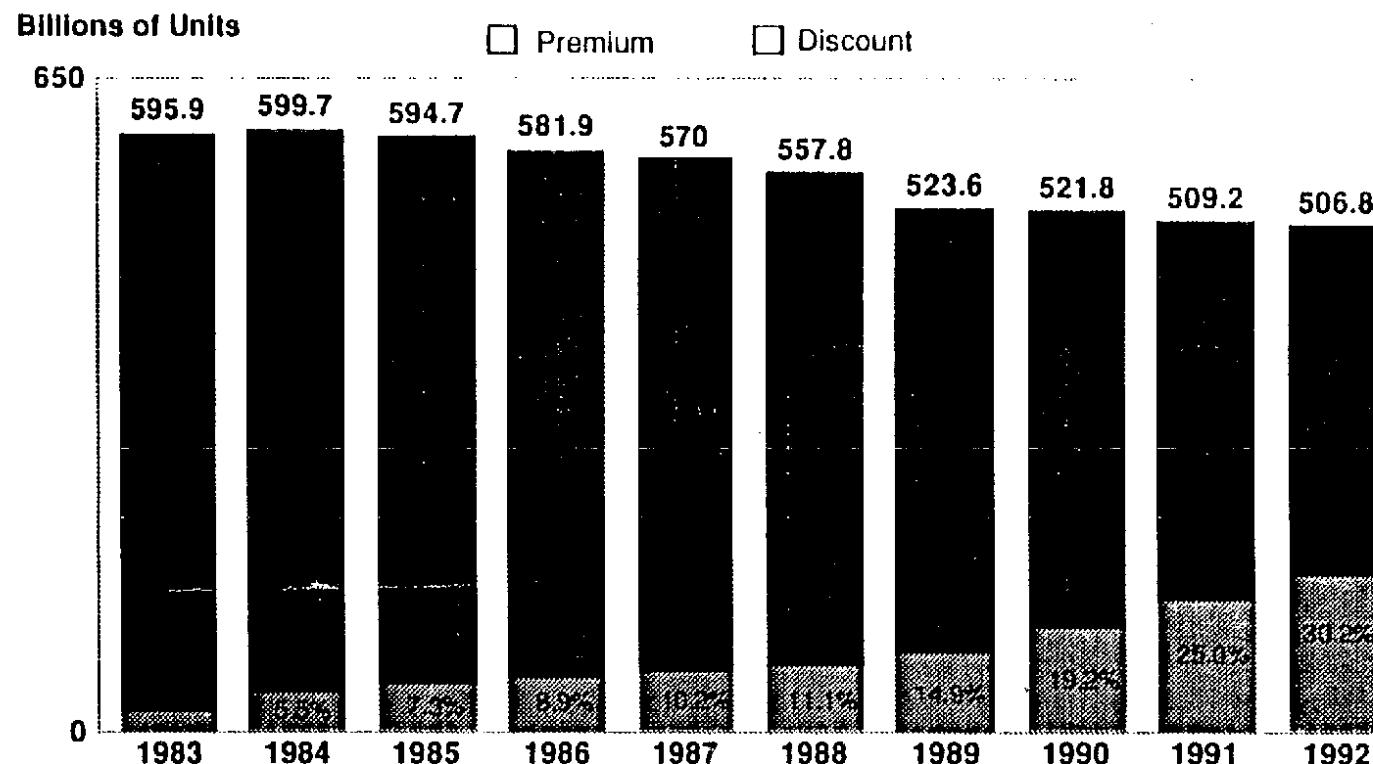


(Assumes Average Purchase of 1 Pack per day)

**PM-USA**  
1993-97 FYP #5

2073445469

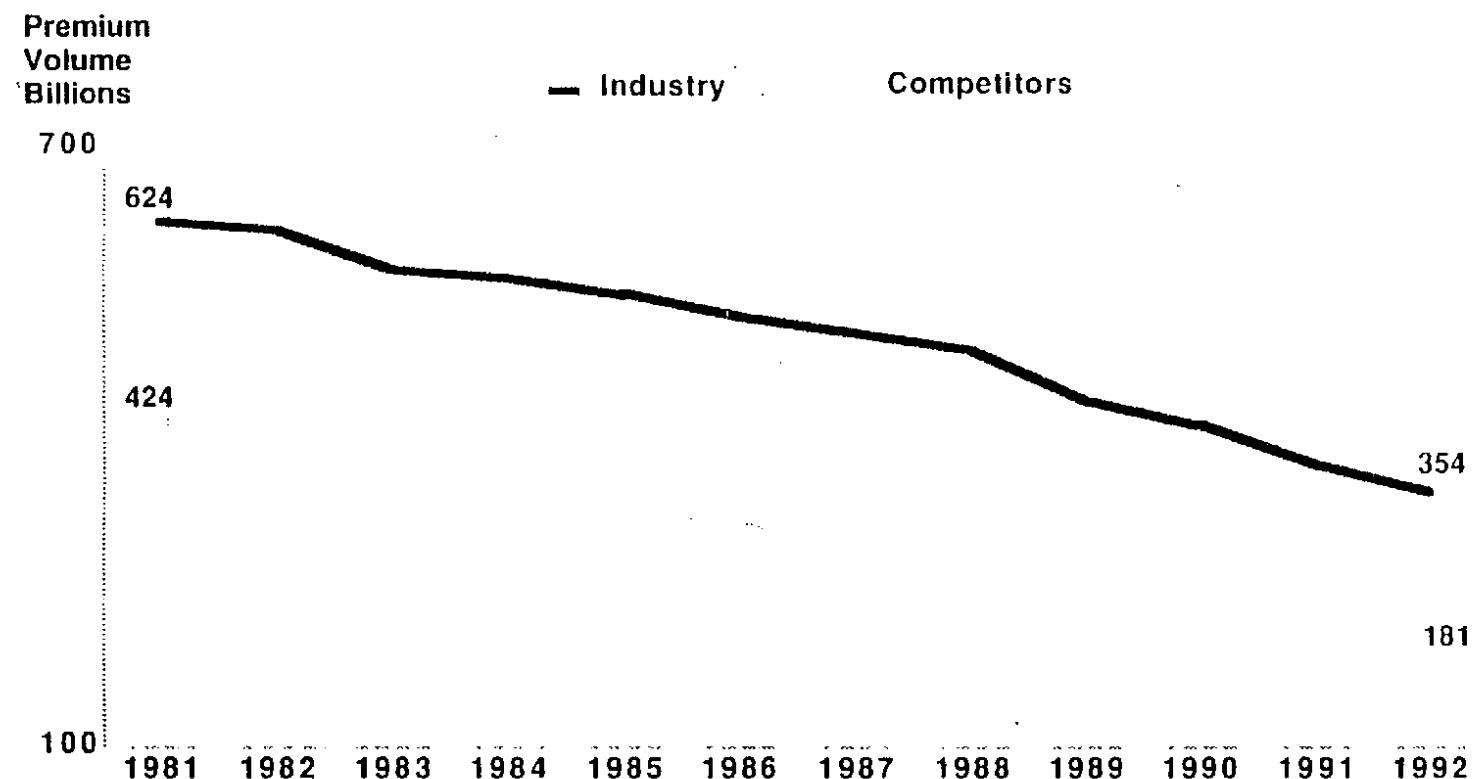
**Since 1983 discount volume has been growing at a compound annual rate of 25.5% (1989-92 CAG 25.2%)**



**PM-USA**  
FYP Pres. 2/10/93 #4

2073445470

Since 1981, premium volume has dropped 5% annually, 270 billion units, with PM-USA's competitors accounting for 90% of the loss (1989-92 CAG - 7.4%)

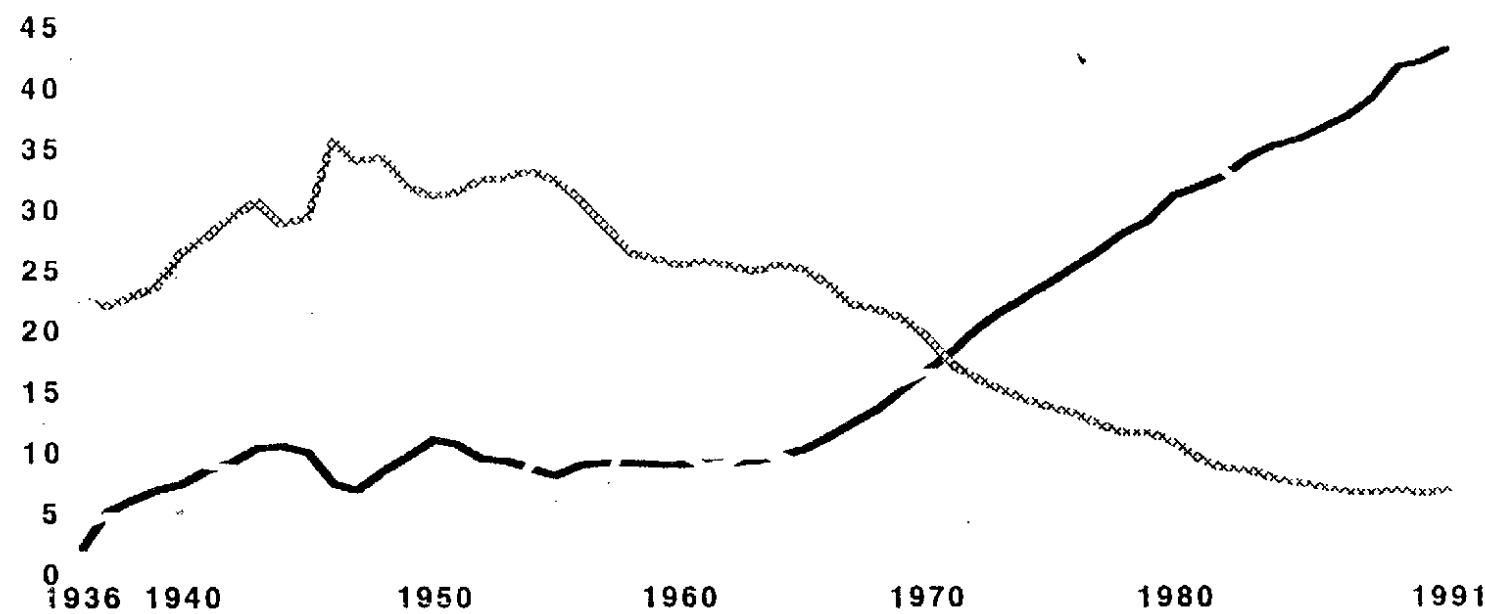


**PM-USA**  
1993-97 FYP Pres 2/10/93 #2

2073445471

# Company Market Shares 1936-1991

— PM  
RJR  
B&W  
Lorillard  
- - - American  
— Liggett

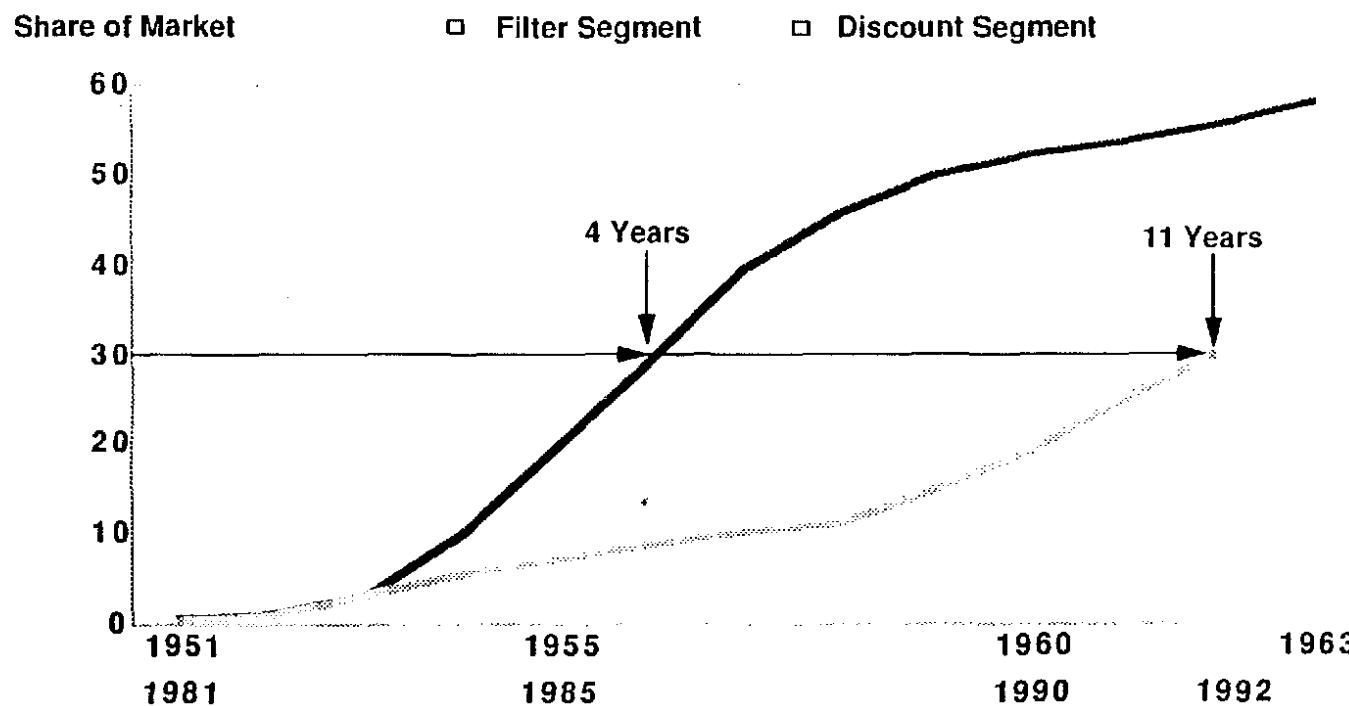


**PM-USA**  
1993-97 FYP Pres. 2/10/93

2073445472

Introduced in 1947, filtered cigarettes did not grow rapidly until the health controversies of the early 1950's.

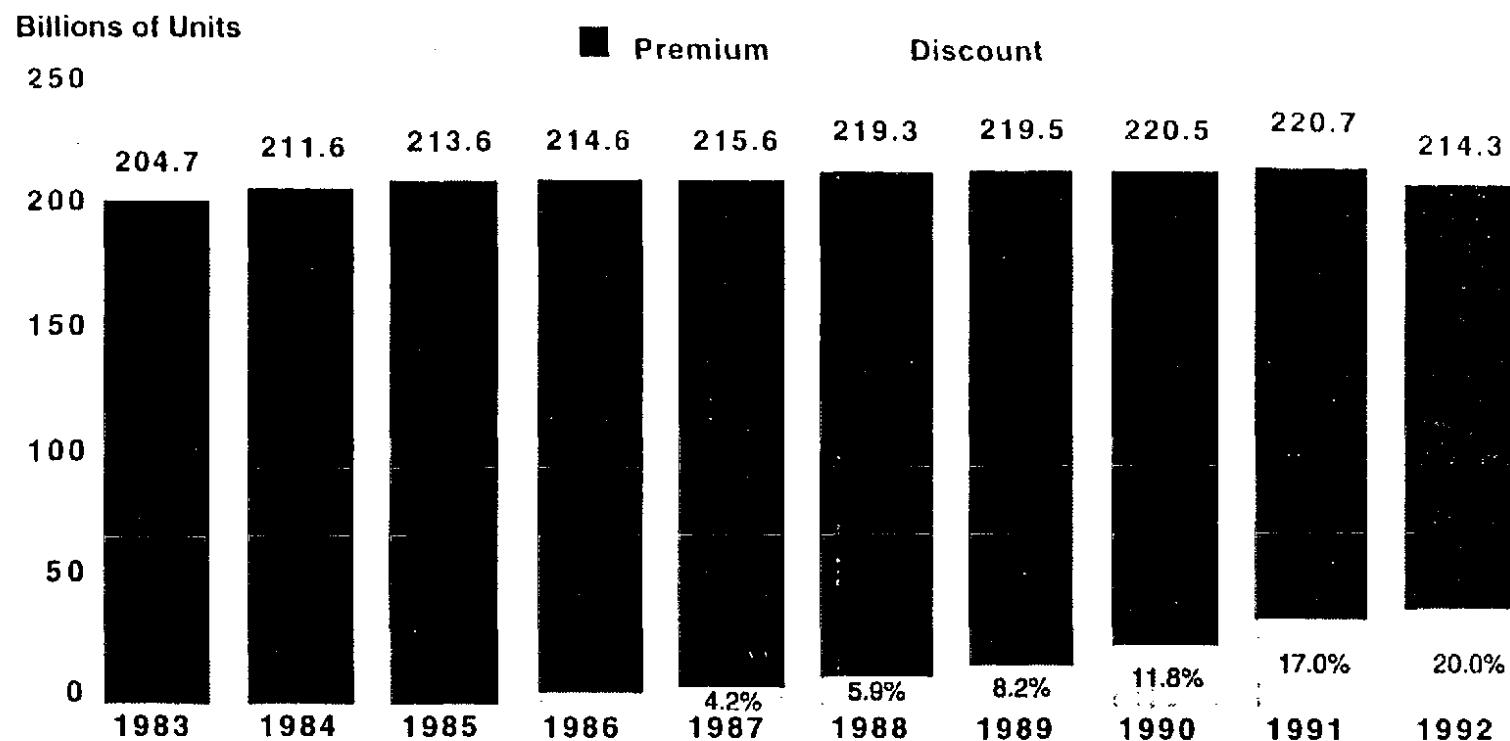
Introduced in 1981, discount cigarettes grew steadily as premium prices widened the gap with discount



**PM-USA**  
1993-97 FYP Pres. 2/10/93

2073445473

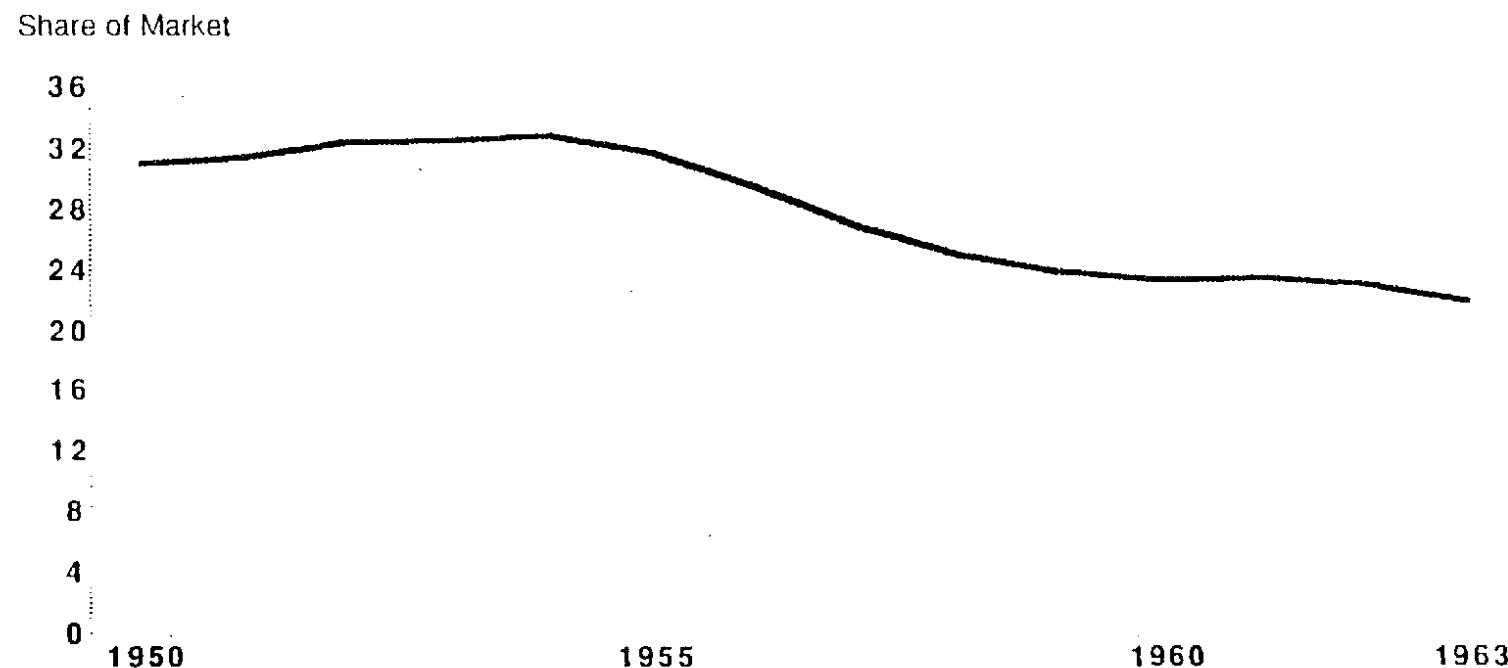
# Philip Morris is following the industry trend with about a 3 year lag



**PM-USA**  
1993-97 FYP Pres. 2/10/93

2073445474

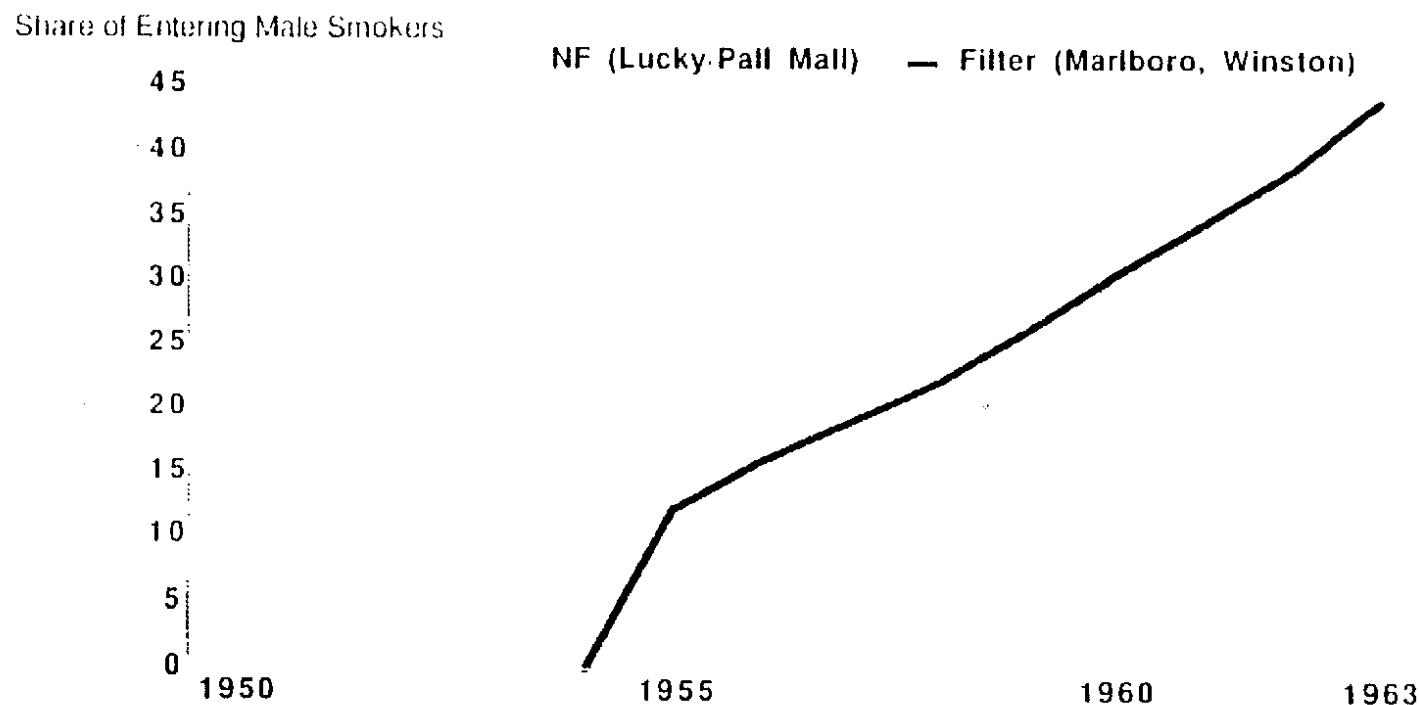
American was able to hold its SOM during the early years of filter growth, most likely due to its strength among entering smokers.



**PM-USA**  
1993-97 FYP Pres 2/10/93

2073445475

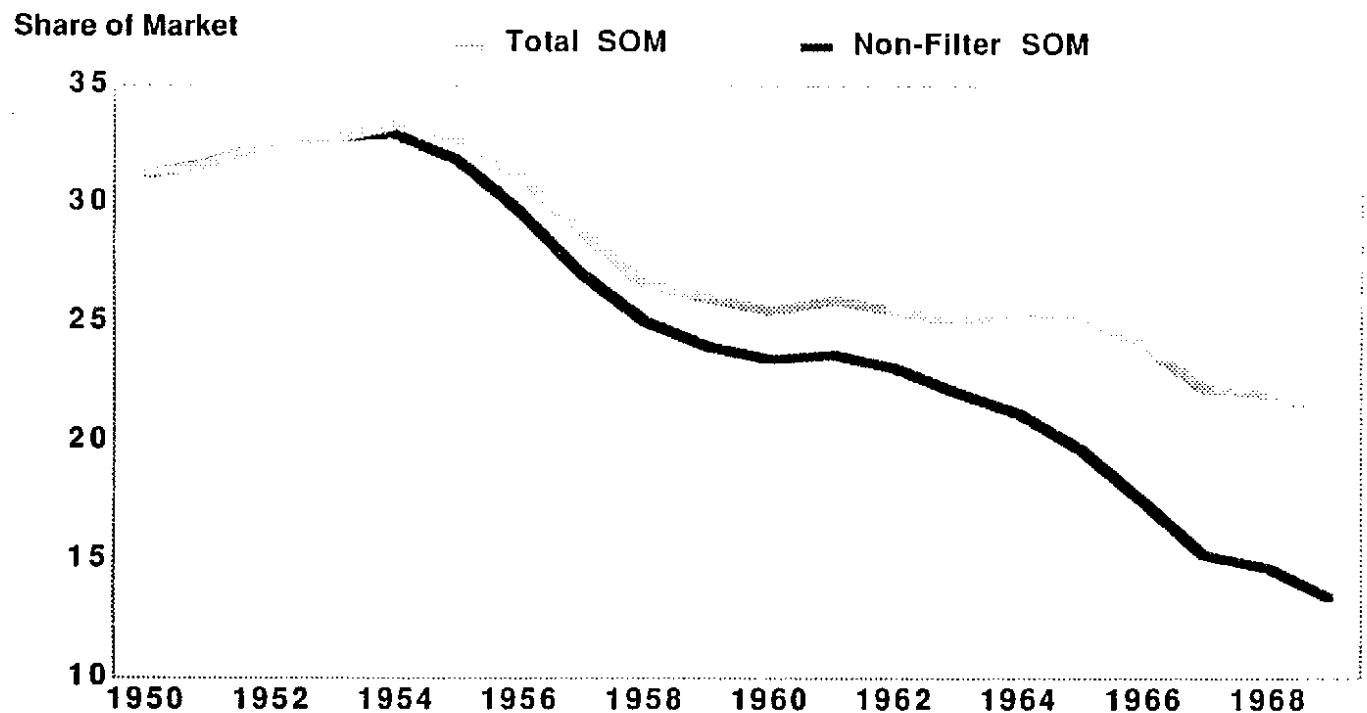
American's overall share finally began declining once its Non-Filters share of entering smokers declined and filters grew.



**PM-USA**  
1993-97 FYP Pres. 2 10 91

2073445476

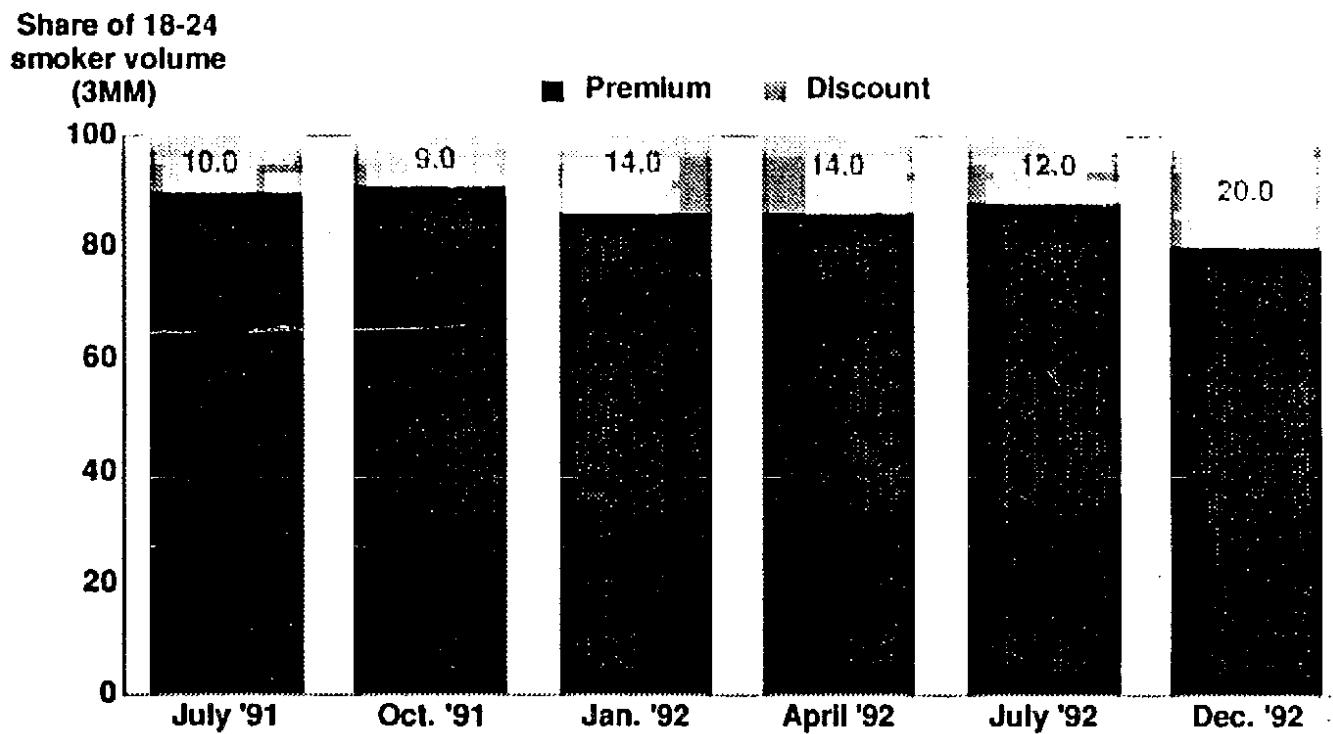
American's market share declined because its filter share gains did not offset the non-filter share losses.



**PM-USA**  
1993-97 FYP Pres. 2/10/93

2073445477

**Discount's share of 18-24 year old volume has doubled since July 1991.**

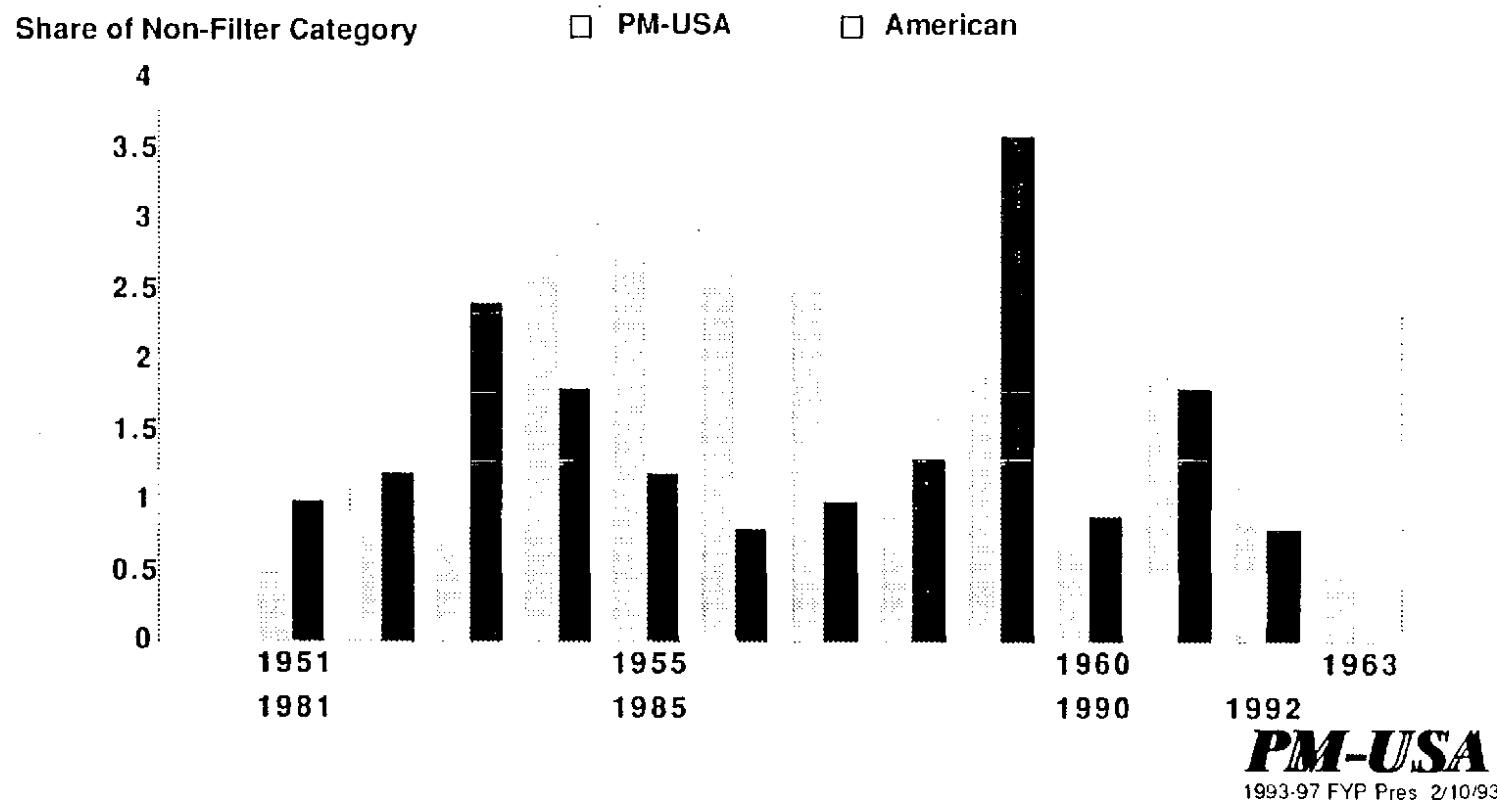


**PM-USA**  
1993-97 FYP #5

2073445478

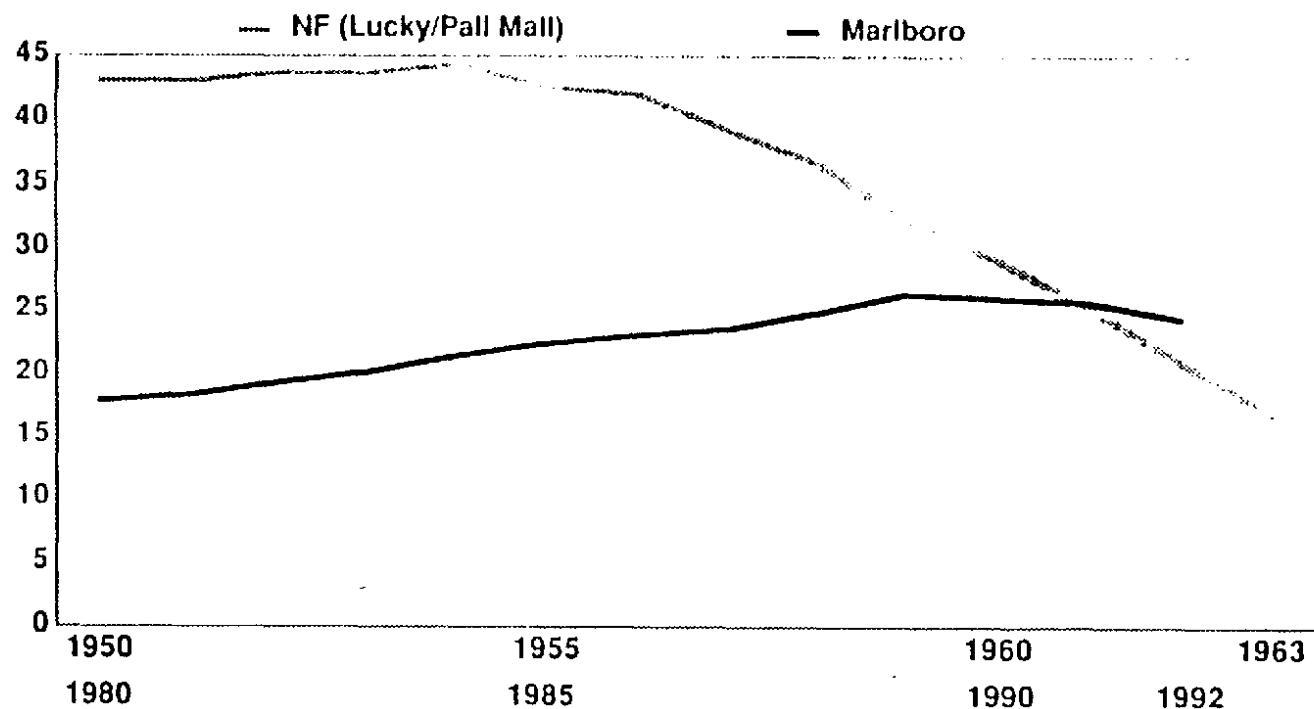
American's share of the declining non-filter category rose almost three points each year.

PM-USA's share growth in the declining premium category is also strong.



2073445479

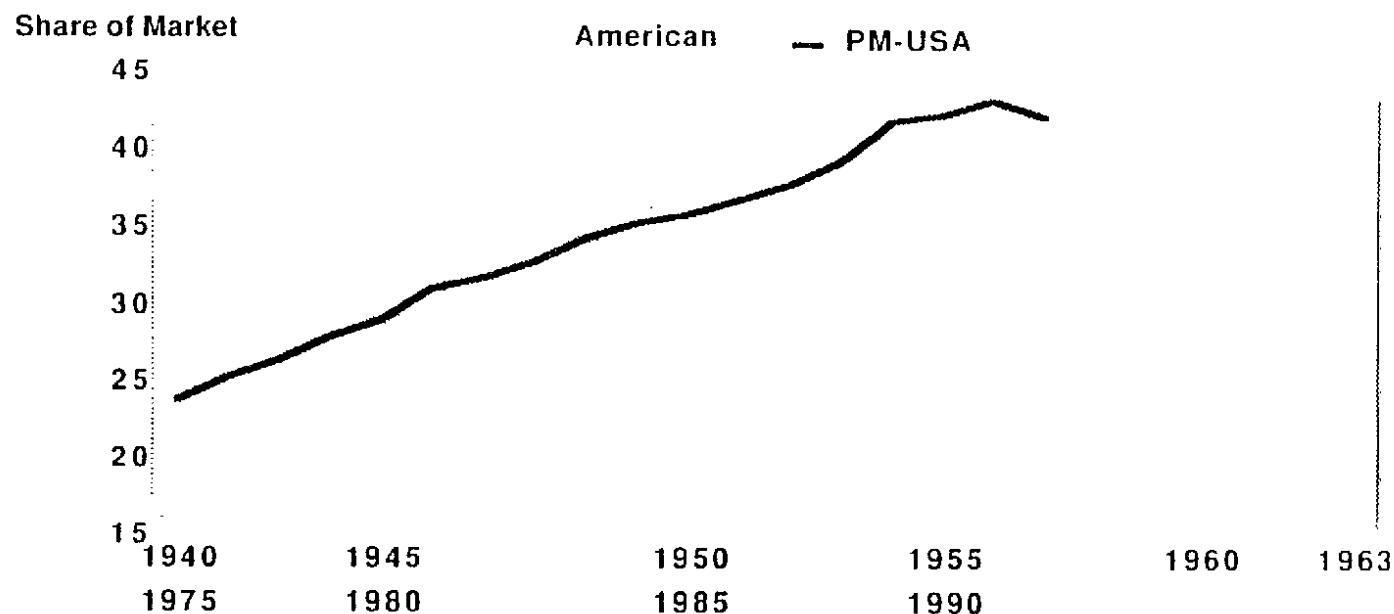
**American's Non-Filters (Lucky Strike and Pall Mall) lost share as filters started to dominate the market. Marlboro's share peaked in 1989 and has declined as discount growth has accelerated.**



**PM-USA**  
1993-97 FYP Pres 2/10/93

2073445480

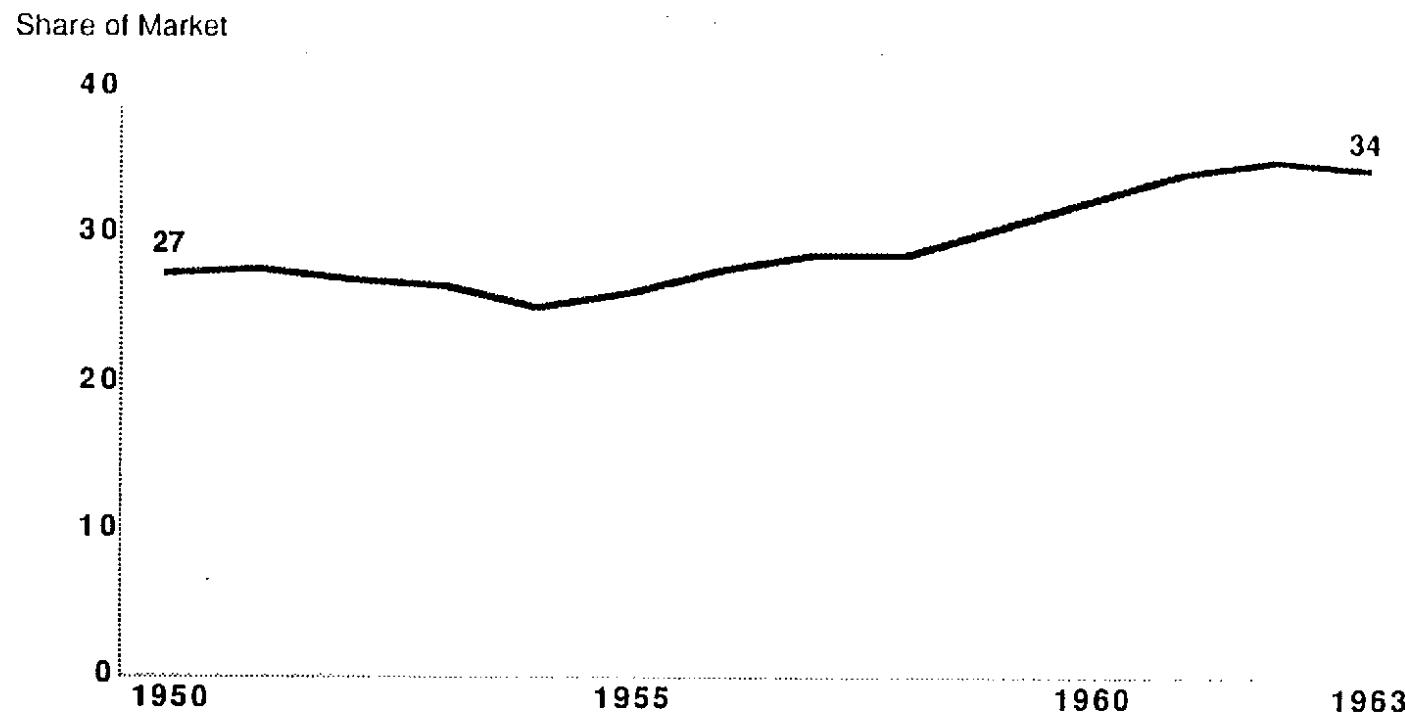
PM-USA's overall share is weakening though its premium performance remains strong.



**PM-USA**  
1993 97 FYP Pres 2-10/93

2073445481

**After being surpassed by American in the 1930's, R.J. Reynolds grew its share of market during the rapid growth of the filter category.**

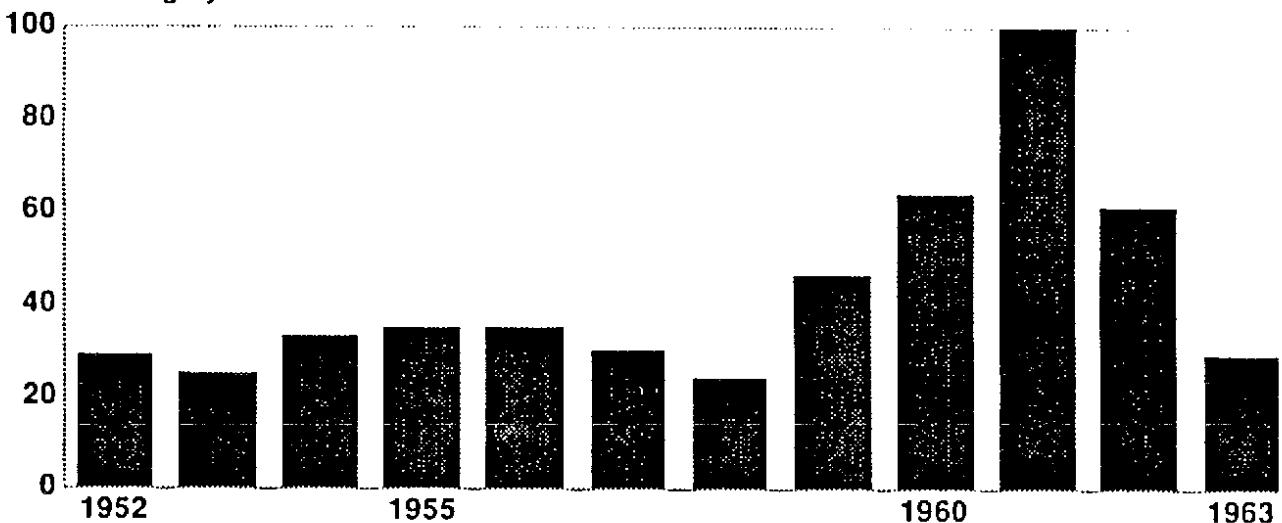


**PM-USA**  
1993-97 FYP Pres. 2/10/93

2073445482

**R J Reynolds consistently captured a substantial share of filter category growth.**

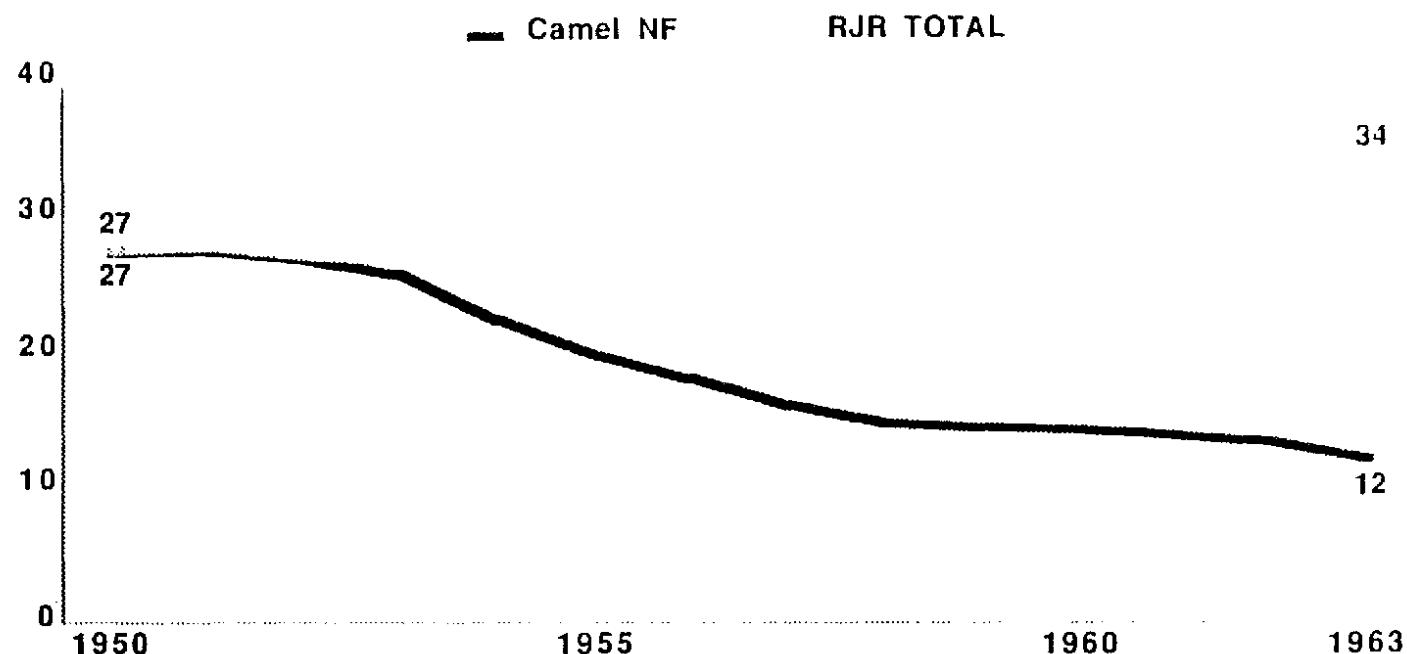
Percent of Filter Category Growth



**PM-USA**  
1993-97 FYP Pres. 2/10/93

2073445483

**R.J. Reynolds was able to hold their Market share because of their filter brands (Winston and Salem) even though Camel NF declined.**

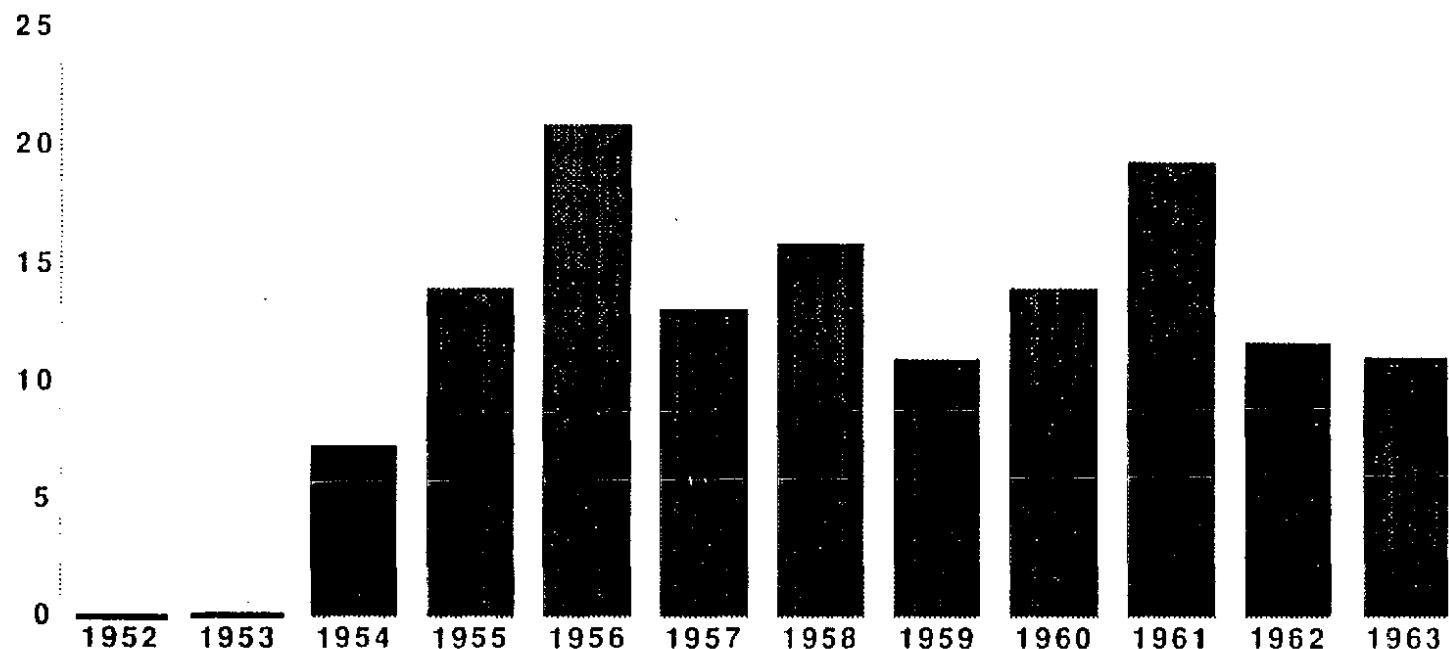


**PM-USA**  
1993-97 FYP Pres 2/10/93

2073445484

**Relative to its overall market share, PM-USA captured a sizeable portion of filter category growth.**

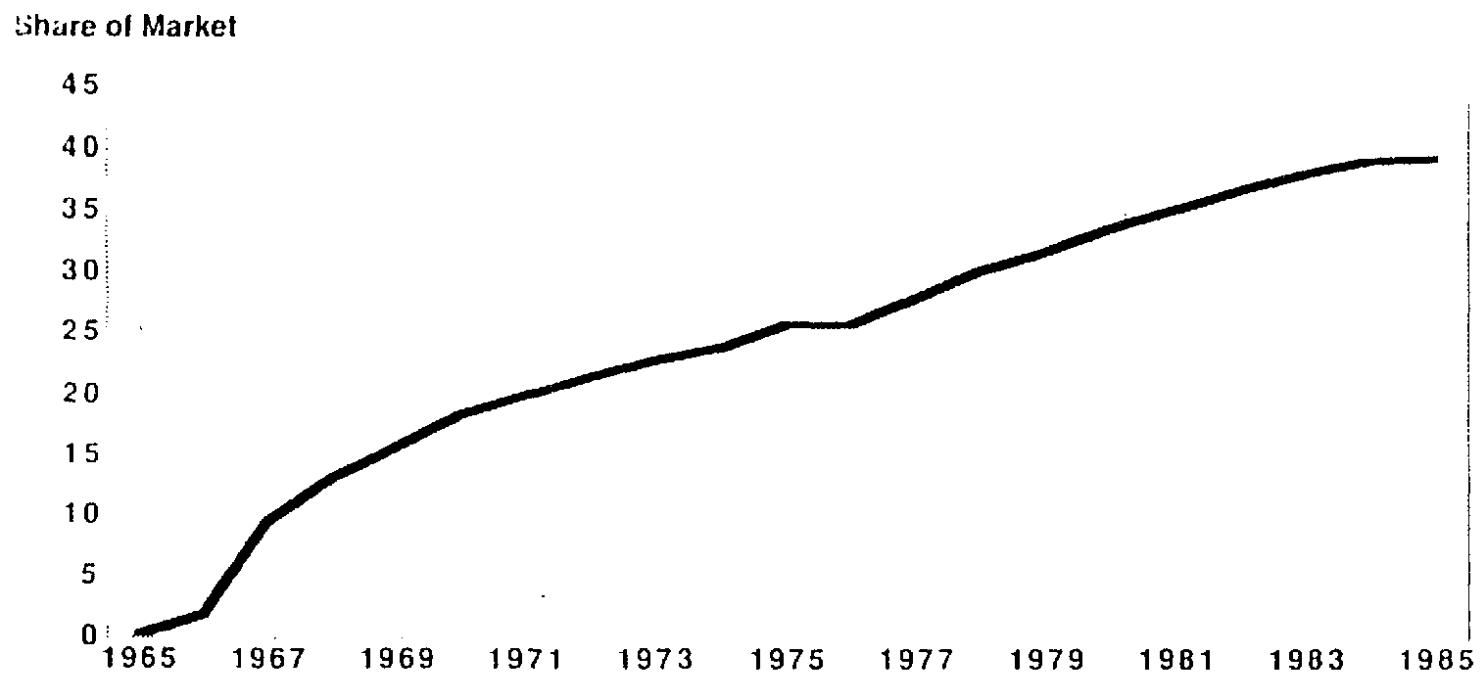
Percent of Filter Category Growth



**PM-USA**  
1993 97 FYP Pres. 2 10 93

2073445485

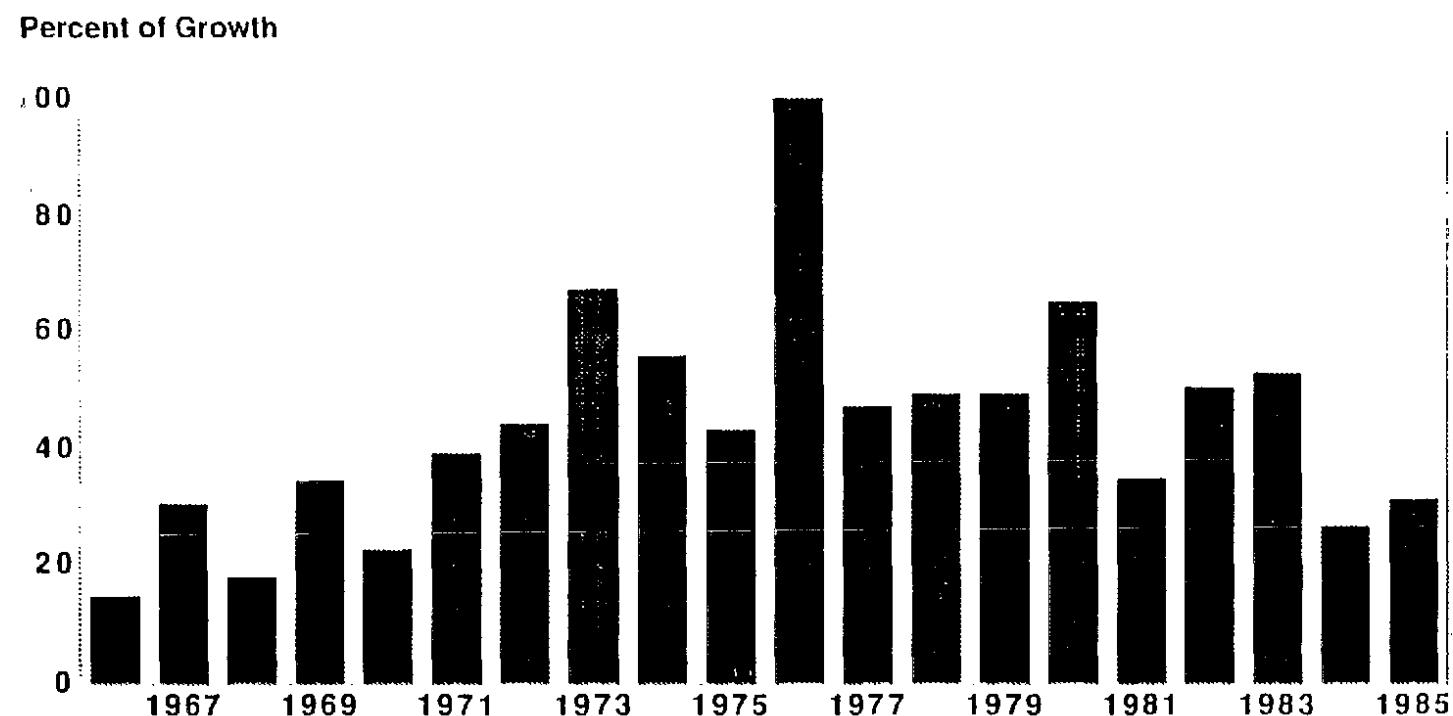
100's grew steadily after their introduction in 1965 and neared their peak by 1984.



**PM-USA**  
1993 97 FYP Pres 2/10 93

2073445486

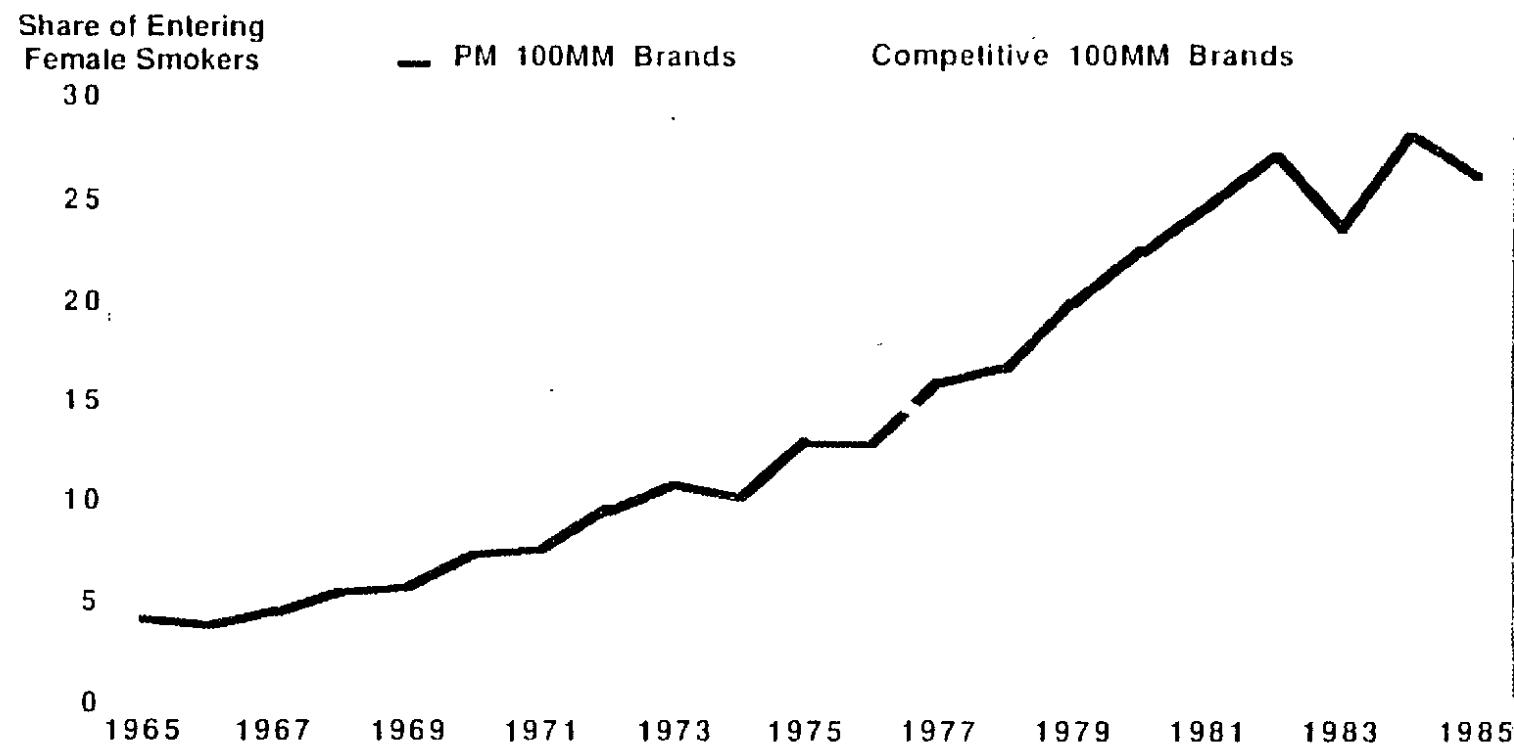
**PM-USA's brands captured a substantial portion of the 100mm category's growth.**



**PM-USA**  
1993-97 FYP Pres 2/10/93 #2

2073445487

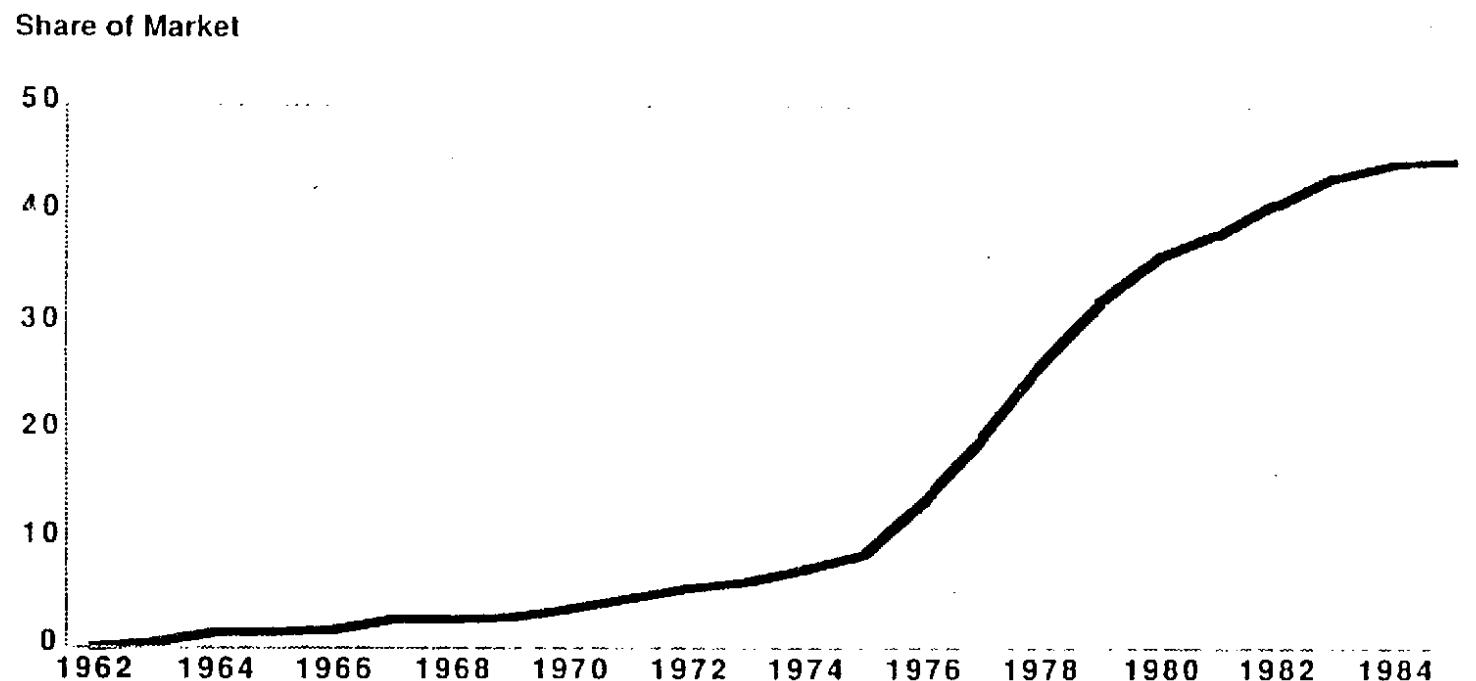
**PM's 100mm brands were chosen by more entering female smokers than all competitors' 100mm brands starting in 1977.**



**PM-USA**  
FYP Proc. 12194

2073445488

**The low tar category grew rapidly from the mid-70's to mid-80's.**

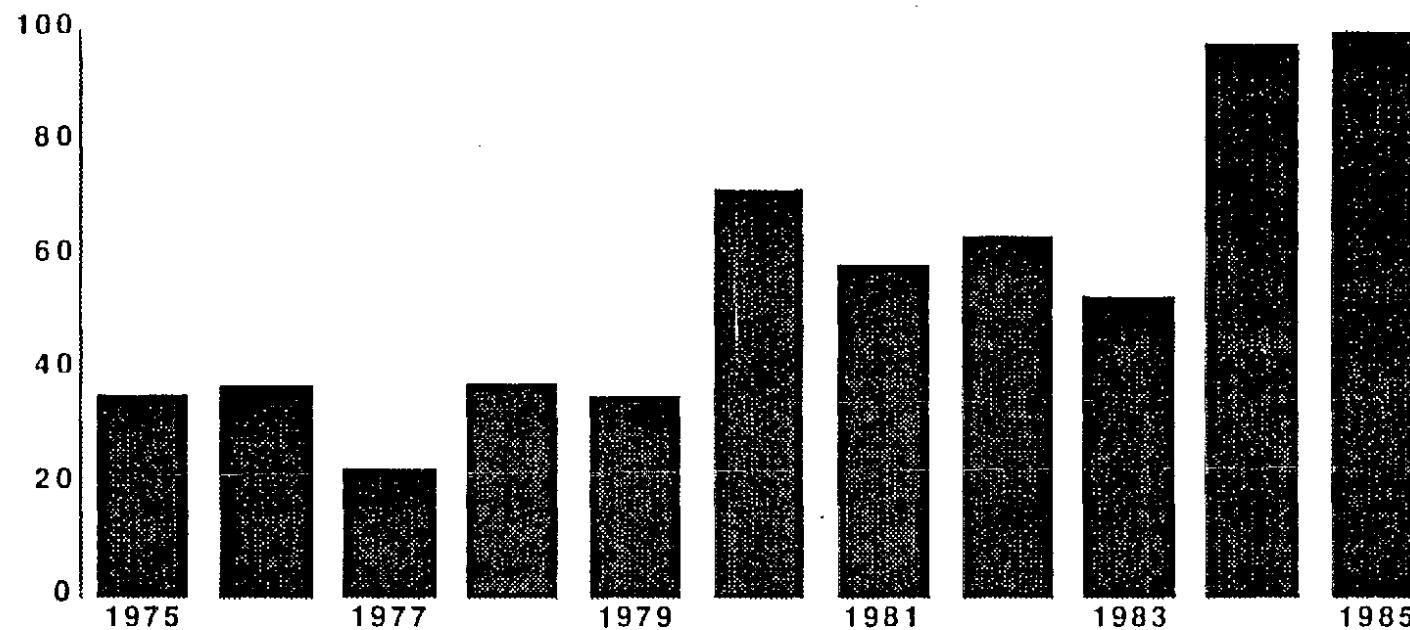


**PM-USA**  
1993 97 FYP Pres. 2/10 93

2073445489

**PM-USA has consistently gotten a large share of the low tar category's growth.**

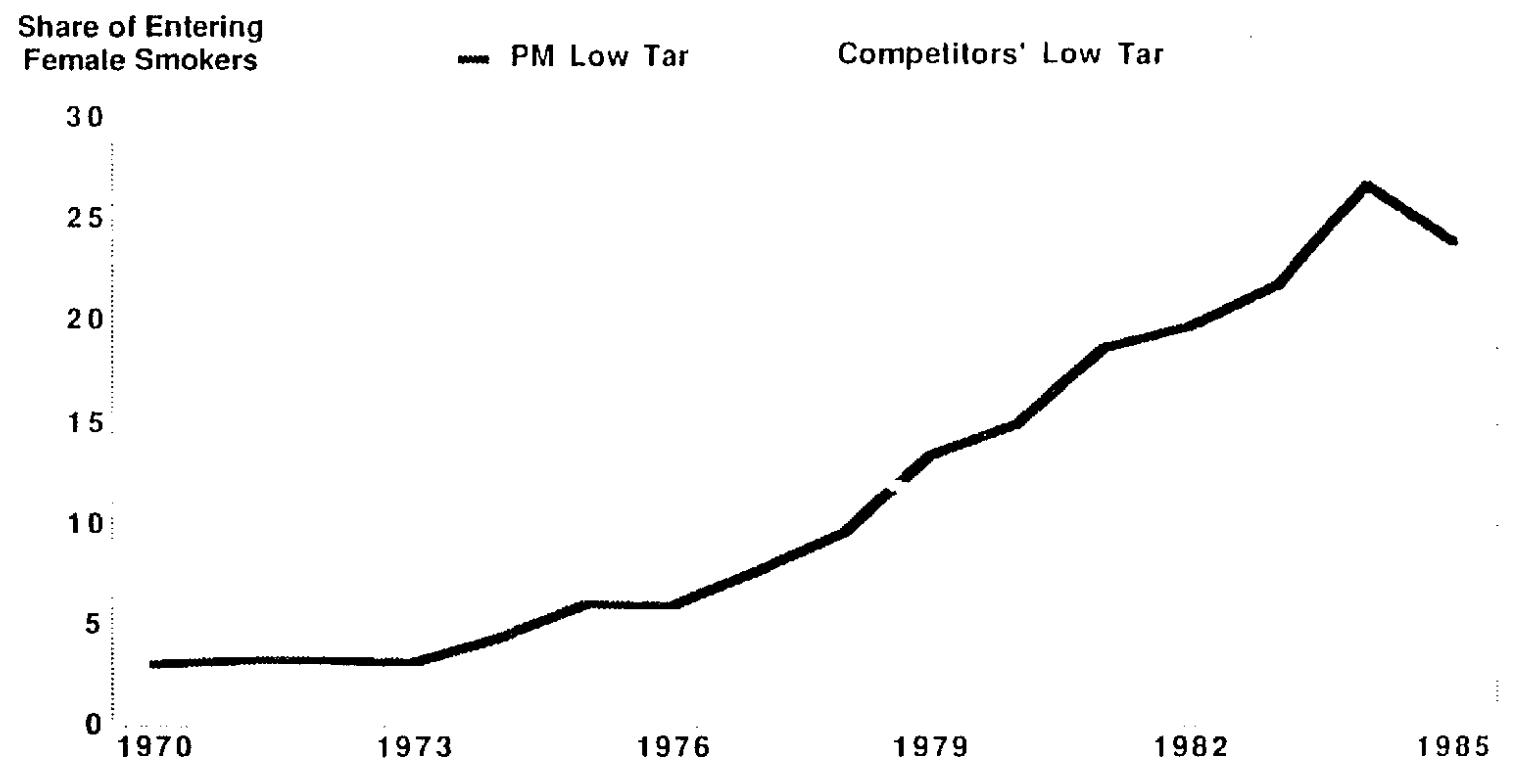
Share of Category Growth



**PM-USA**  
1993 97 FYP Pres 2/10 93

2073445490

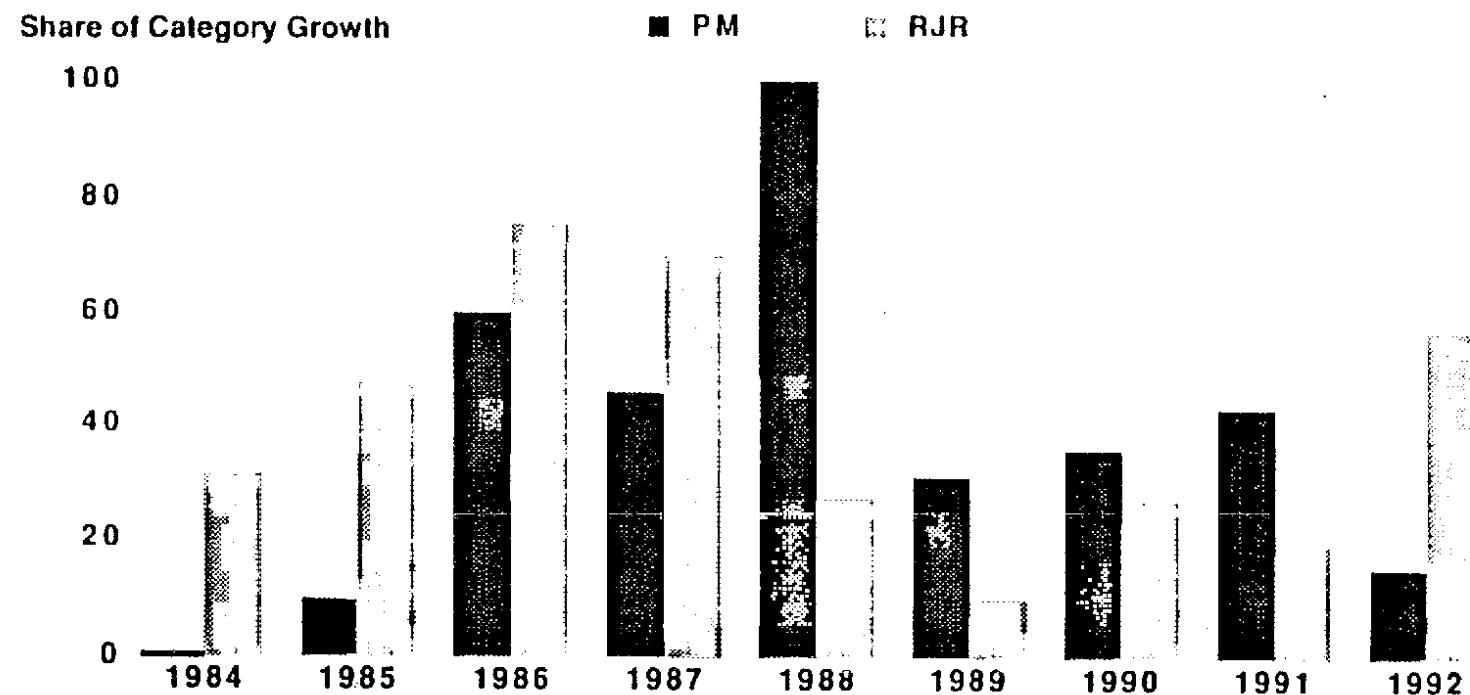
**PM's low tar brands were chosen by more entering female smokers than all competitors' low tars starting in 1979**



**PM-USA**  
FYP Pres. 1 21:93

2073445491

**Between 1988 and 1991 PM-USA captured a greater share of discount growth than RJR.**



Source: MSA Shipments

**PM-USA**  
1993-97 FYP Pres 2/10/93

2073445492

**R J Reynolds has a larger share of young adults' discount purchases than PM-USA.**

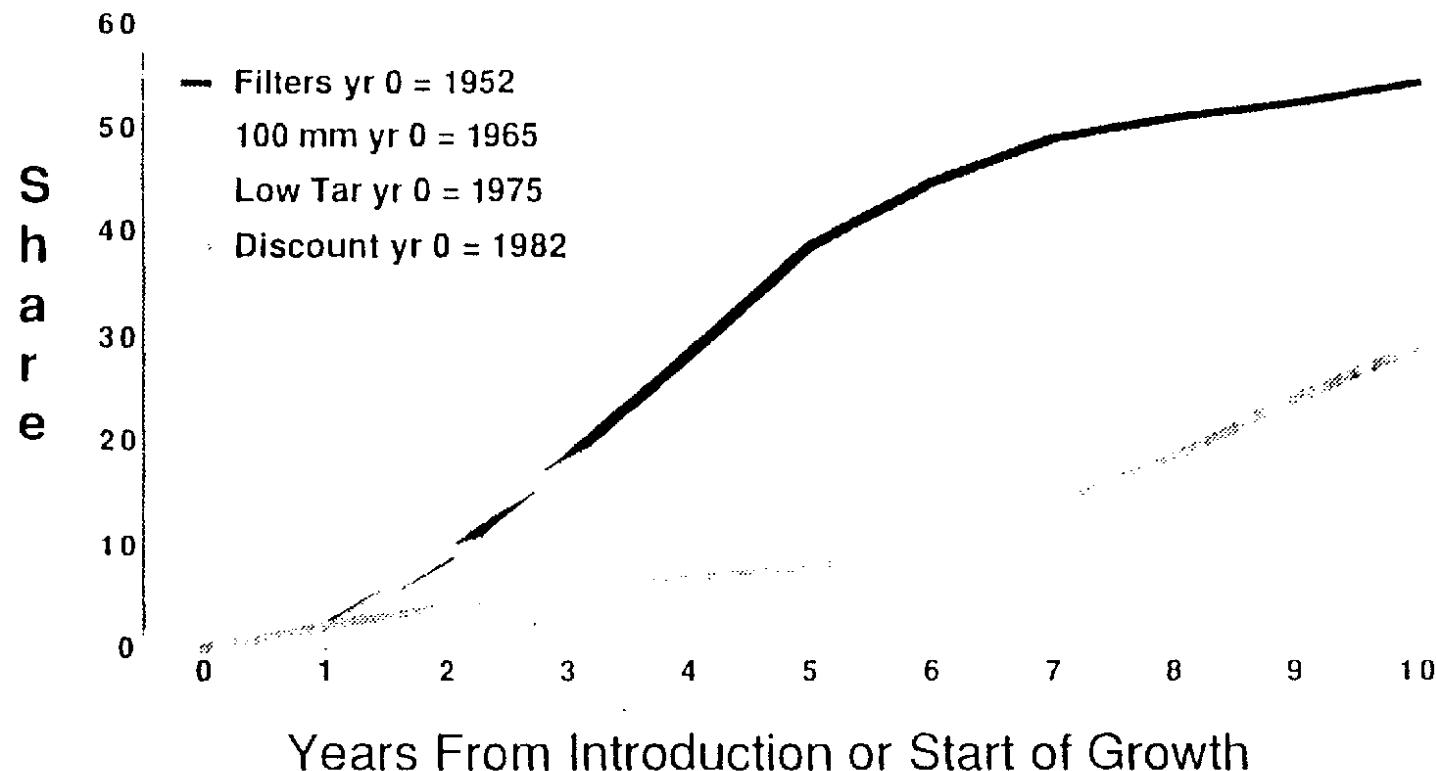
**Percent of 18-24 year olds' discount purchases**

|          | <u>1991</u> | <u>1992</u> |
|----------|-------------|-------------|
| PM-USA   | 27.9%       | 28.7%       |
| RJR      | 38.1        | 35.8        |
| American | 13.7        | 17.9        |
| B&W      | 16.8        | 12.5        |

**PM-USA**  
1993-97 FYP Pres. 2/10/93

2073445493

**The discount category has shown growth similar to other secular trends in the marketplace.**

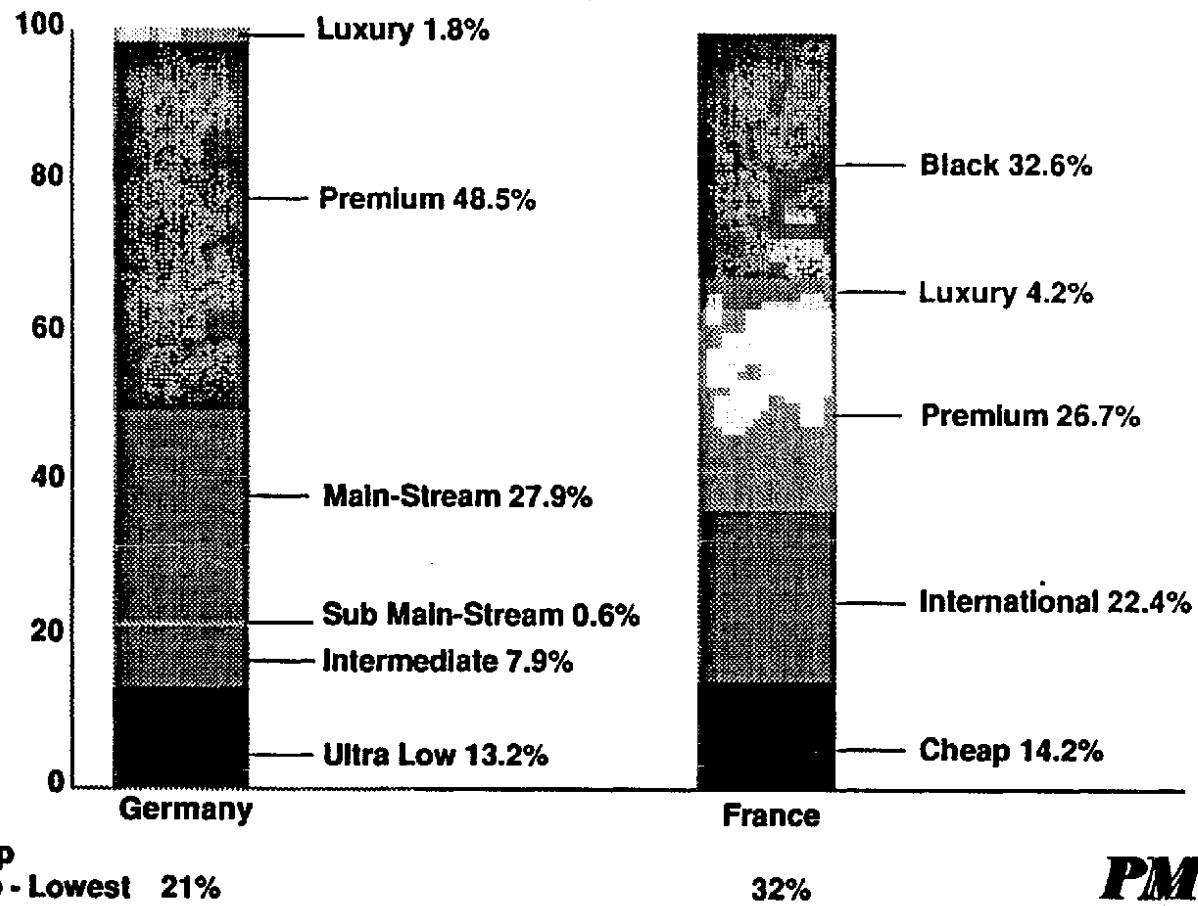


**PM-USA**  
1993 97 FYP Pres 2/10/93

2073445494

**In both France and Germany, at least one mid-tier separates Marlboro from the lowest price brands.**

**Share of Market %**



2073445495

# Implications

- Discount looks like major market shift
- Its magnitude is more than 100mm, less than filters, perhaps closest to low tar
- Market leaders are especially vulnerable in such shifts
- Some evidence of PMUSA's vulnerability
- RJR may be playing same role now as it did with American in the 1950s

**PM-USA**  
FYP Pres. 2/10/93 #4

## Current Downside

|                        | <u>1992</u>  | <u>1997</u>  | <u>CAG</u>    |
|------------------------|--------------|--------------|---------------|
| <b>Industry Volume</b> | <b>506.8</b> | <b>442.0</b> | <b>-2.7%</b>  |
| <b>Premium</b>         | <b>353.7</b> | <b>176.5</b> | <b>-12.9%</b> |
| <b>Discount</b>        | <b>153.1</b> | <b>265.2</b> | <b>+11.6%</b> |
| <b>Discount Share</b>  | <b>30.2%</b> | <b>60.0%</b> |               |
| <br>                   |              |              |               |
| <b>PM-USA Volume</b>   | <b>214.3</b> | <b>192.5</b> | <b>-2.1%</b>  |
| <b>Premium</b>         | <b>172.8</b> | <b>100.6</b> | <b>-10.3%</b> |
| <b>Discount</b>        | <b>41.5</b>  | <b>91.9</b>  | <b>+17.2%</b> |

**PM-USA**  
1993-97 FYP Pres 2/10/93 #2

2073445497

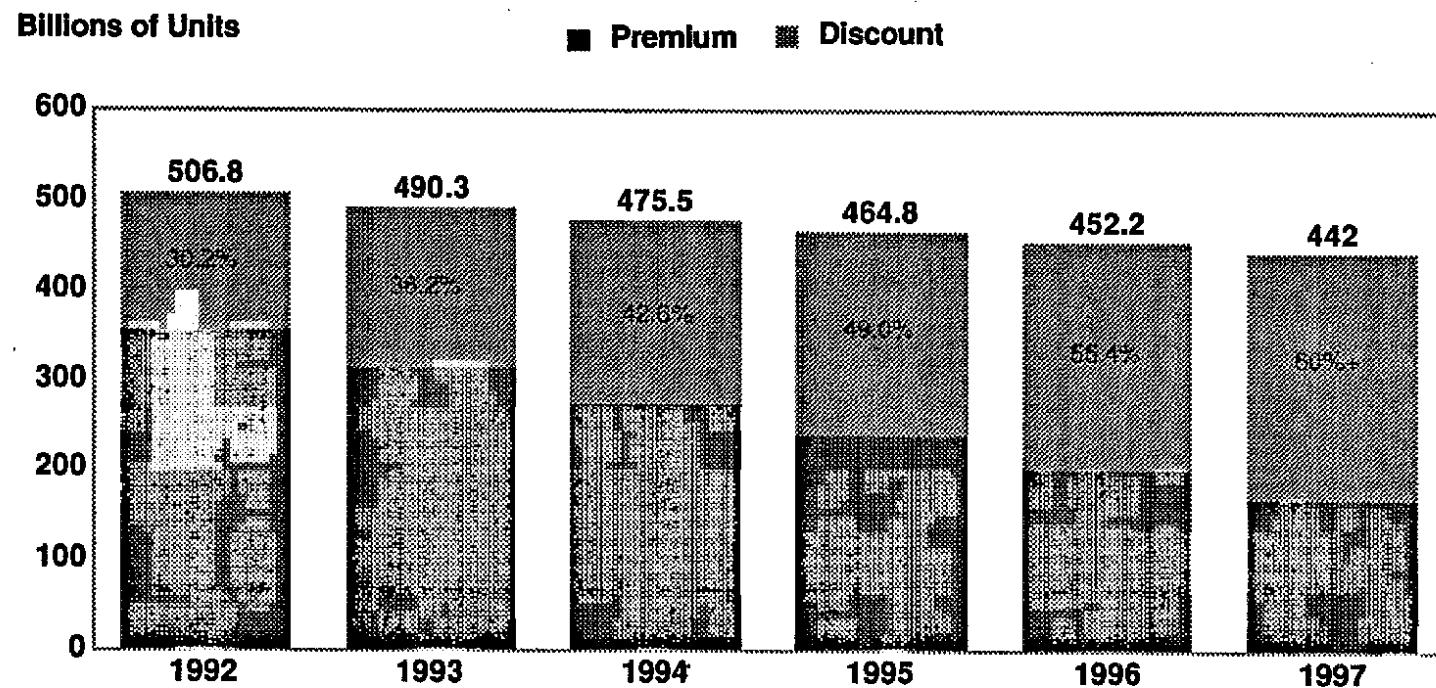
## Scenario Comparison (1997)

|                        | <u>Current</u> | <u>Downside</u> |
|------------------------|----------------|-----------------|
| <b>Industry Volume</b> | 442.0          | 442.0           |
| Premium                | 220.1          | 176.5           |
| Discount               | 221.9          | 265.2           |
| <b>Discount Share</b>  | 50.2           | 60.0            |
| <br>                   |                |                 |
| <b>PM-USA Volume</b>   | 194.3          | 192.5           |
| Premium                | 125.3          | 100.6           |
| Discount               | 69.0           | 91.9            |

**PM-USA**  
1993-97 FYP #5

2073445498

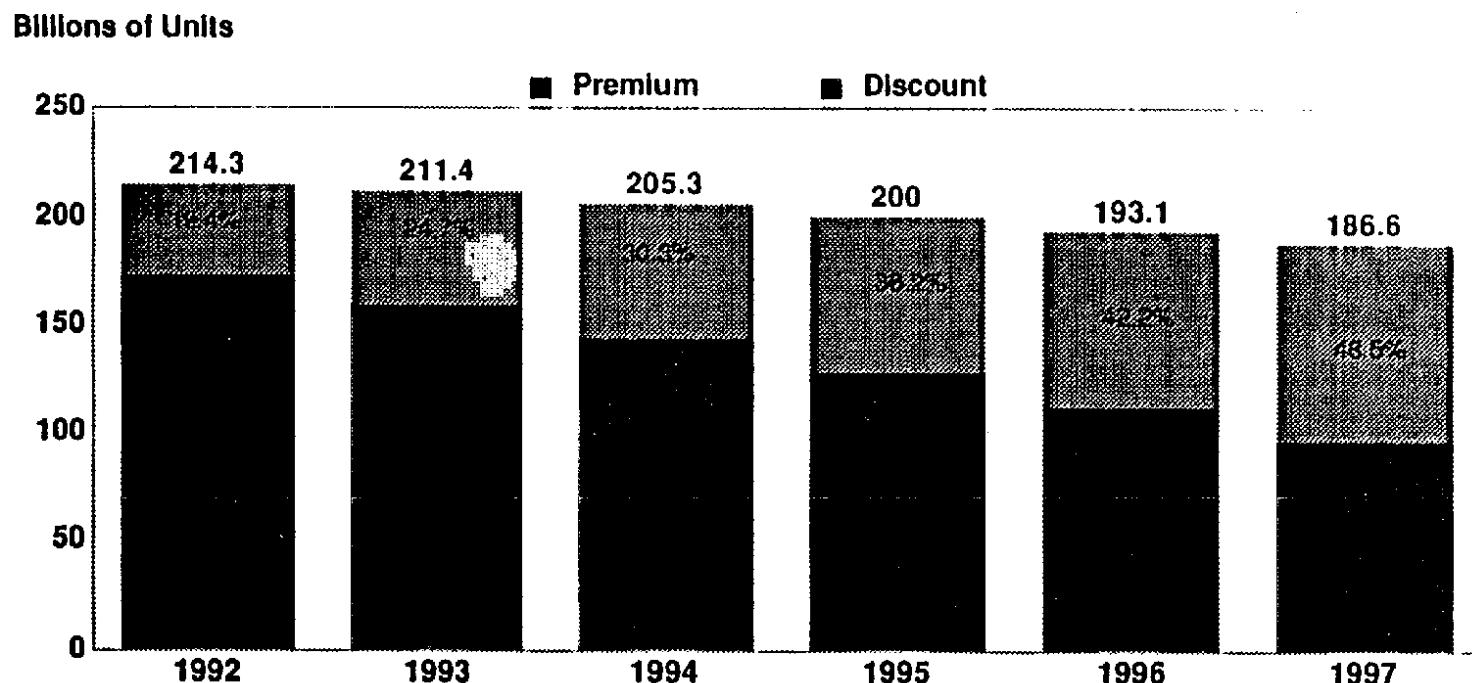
**The Discount category will come to dominate the market.**



**PM-USA**  
FYP Pres. 2/10/93 #4

2073445499

## Philip Morris' trend will continue to lag the industry over the plan period



**PM-USA**  
FYP Pres. 2/10/93 #4

2073445500

## Current Downside Total Volume

|             | <u>1987</u> | <u>1992</u> | <u>87-92<br/>CAG</u> | <u>1997</u> | <u>92-97<br/>CAG</u> |
|-------------|-------------|-------------|----------------------|-------------|----------------------|
| PM-USA      | 215.6       | 214.3       | -0.1%                | 186.6       | -2.7%                |
| RJR         | 185.3       | 146.2       | -4.6                 | 140.2       | -0.8                 |
| B&W         | 62.7        | 60.2        | -0.8                 | 49.0        | -4.0                 |
| Lorillard   | 46.7        | 36.5        | -4.8                 | 26.9        | -5.9                 |
| American    | 39.3        | 34.3        | -2.7                 | 24.8        | -6.2                 |
| Liggett     | 20.4        | 15.2        | -5.7                 | 14.5        | -0.8                 |
| <hr/> Total | <hr/> 570.0 | <hr/> 506.8 | <hr/> -2.3%          | <hr/> 442.0 | <hr/> -2.7%          |

**PM-USA**  
1993-97 FYP Pres 2/10/93 #2

2073445501

## Current Downside Premium Volume

|             | <u>1987</u> | <u>1992</u> | <u>87-92<br/>CAG</u> | <u>1997</u> | <u>92-97<br/>CAG</u> |
|-------------|-------------|-------------|----------------------|-------------|----------------------|
| PM-USA      | 206.6       | 172.8       | -3.5%                | 96.0        | -11.1%               |
| RJR         | 163.1       | 95.4        | -10.2                | 29.8        | -20.8                |
| B&W         | 49.6        | 26.7        | -11.7                | 9.3         | -19.0                |
| Lorillard   | 46.7        | 35.0        | -5.6                 | 25.3        | -6.3                 |
| American    | 37.9        | 19.0        | -12.9                | 6.4         | -19.6                |
| Liggett     | 7.8         | 4.7         | -9.6                 | 1.9         | -16.6                |
| <hr/> Total | <hr/> 511.7 | <hr/> 353.7 | <hr/> -7.1%          | <hr/> 168.8 | <hr/> -13.8%         |

**PM-USA**  
1993-97 FYP Pres 2/10/93 #2

2073445502

## Current Downside Discount Volume

|              | <u>1987</u> | <u>1992</u>  | <u>87-92<br/>CAG</u> | <u>1997</u>  | <u>92-97<br/>CAG</u> |
|--------------|-------------|--------------|----------------------|--------------|----------------------|
| PM-USA       | 9.0         | 41.5         | +35.7%               | 90.6         | +16.9%               |
| RJR          | 22.2        | 50.8         | +18.0                | 110.4        | +16.8                |
| B&W          | 13.1        | 33.5         | +20.6                | 39.7         | +3.4                 |
| Lorillard    | 0.0         | 1.5          | N/A                  | 1.6          | +4.3                 |
| American     | 1.4         | 15.3         | +61.3                | 18.4         | +3.8                 |
| Liggett      | 12.6        | 10.5         | -3.8                 | 12.6         | +3.7                 |
| <b>Total</b> | <b>58.3</b> | <b>153.1</b> | <b>+21.3%</b>        | <b>273.2</b> | <b>+12.3%</b>        |

**PM-USA**  
1993-97 FYP Pres 2/10/93 #2

2073445503

## Current Downside

**Assumptions:**

**PM SOP +1.6%**

**PM SOD Growth 40%**

|      | Price Increase |           | Effective<br>Retail Price |           |         |
|------|----------------|-----------|---------------------------|-----------|---------|
|      | Prem/BD        | Deep Disc | Premium                   | Deep Disc | New Gap |
| 1992 | \$6.00         | —         | \$1.91                    | \$1.05    | 82.3%   |
| 1993 | \$6.00         | \$6.00    | \$2.23                    | \$1.27    | 74.9%   |
| 1994 | \$8.00         | \$1.00*   | \$2.56                    | \$1.37    | 86.9%   |
| 1995 | \$9.50         | \$1.00    | \$2.82                    | \$1.43    | 97.2%   |
| 1996 | \$11.00        | \$1.00    | \$3.22                    | \$1.62    | 98.8%   |
| 1997 | \$12.50        | \$1.00    | \$3.54                    | \$1.69    | 109.5%  |

\* Off Invoice Allowance Increases \$5.00/thous

**PM-USA**  
1993-97 FYP Pres 2-10 93 #2

2073445504

# Current Downside

## Income From Operations

|                  | <u>PM-USA</u> | <u>Total<br/>Industry</u> | <u>Industry<br/>%Change</u> | <u>PM-USA Share of Industry</u> |               |
|------------------|---------------|---------------------------|-----------------------------|---------------------------------|---------------|
|                  |               |                           |                             | <u>Total</u>                    | <u>Growth</u> |
| 1992             | 5185          | 9450                      | 4.5%                        | 54.9%                           | 100.0%        |
| 1993             | 5655          | 9963                      | 5.4%                        | 56.8%                           | 91.6%         |
| 1994             | 5827          | 10104                     | 1.6%                        | 57.7%                           | 100.0%        |
| 1995             | 5870          | 9924                      | -1.8%                       | 59.2%                           | —             |
| 1996             | 5874          | 9747                      | -1.8%                       | 60.3%                           | —             |
| 1997             | 5887          | 9597                      | -1.5%                       | 61.3%                           | —             |
| <i>CAG 92-97</i> | <i>2.6%</i>   | <i>0.3%</i>               |                             |                                 |               |

**PM-USA**  
1993 97 FYP Pres 2/10 93 #2

2073445505

## Current Downside Profitability

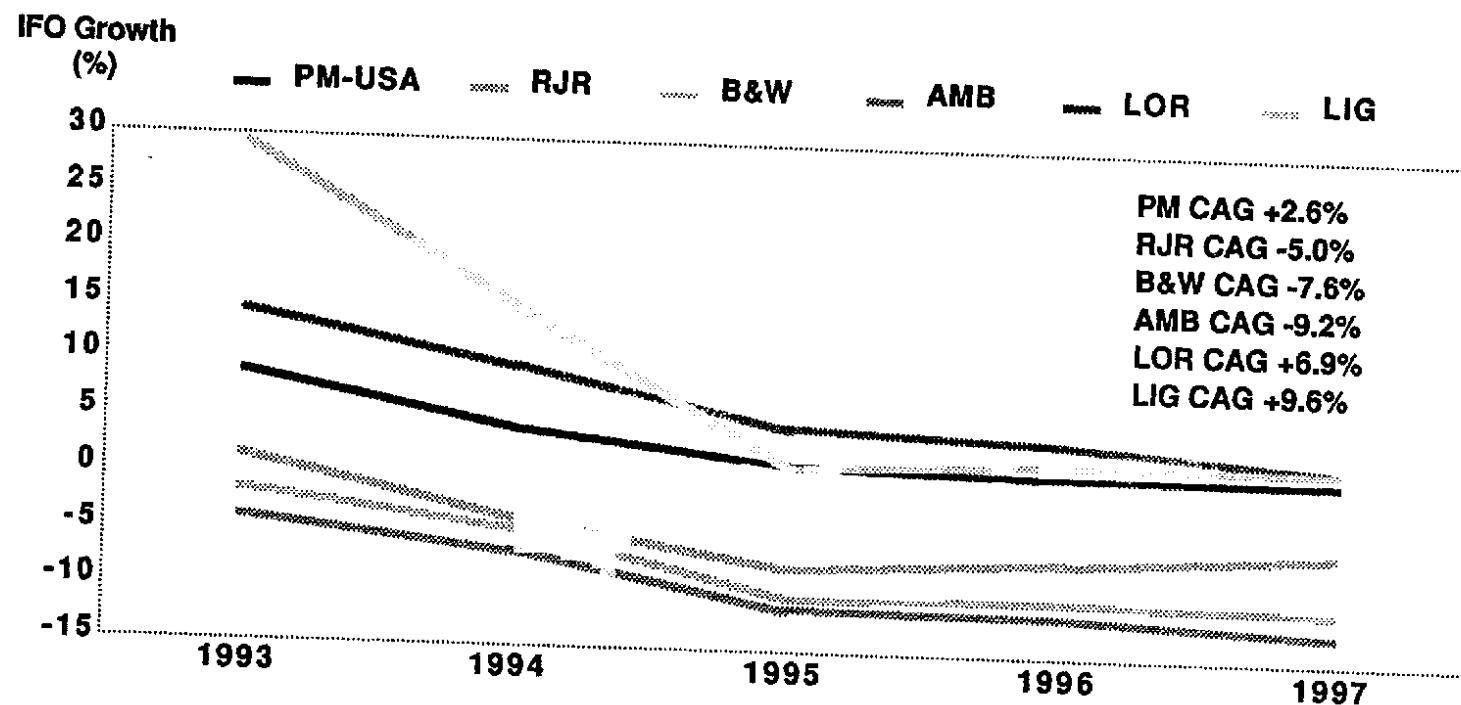
|              | <u>1987</u>    | <u>1992</u>    | 87-92<br><u>CAG</u> | <u>1997</u>    | 92-97<br><u>CAG</u> |
|--------------|----------------|----------------|---------------------|----------------|---------------------|
| PM-USA       | \$2,714        | \$5,185        | +13.8%              | \$5,887        | +2.6%               |
| RJR          | 1,582          | 2,149          | +6.3                | 1,638          | -5.0                |
| B&W          | 516            | 660            | +5.0                | 446            | -7.5                |
| Lorillard    | 502            | 870            | +11.6               | 1,216          | +6.9                |
| American     | 430            | 536            | +4.5                | 330            | -9.2                |
| Liggett      | 57             | 50             | -2.6                | 79             | +9.6                |
| <b>Total</b> | <b>\$5,801</b> | <b>\$9,450</b> | <b>+10.2%</b>       | <b>\$9,597</b> | <b>+0.3%</b>        |

**PM-USA**  
1993 97 FYP Pres 2/10/93 #2

2073445506

# Current Downside

## Annual IFO Growth

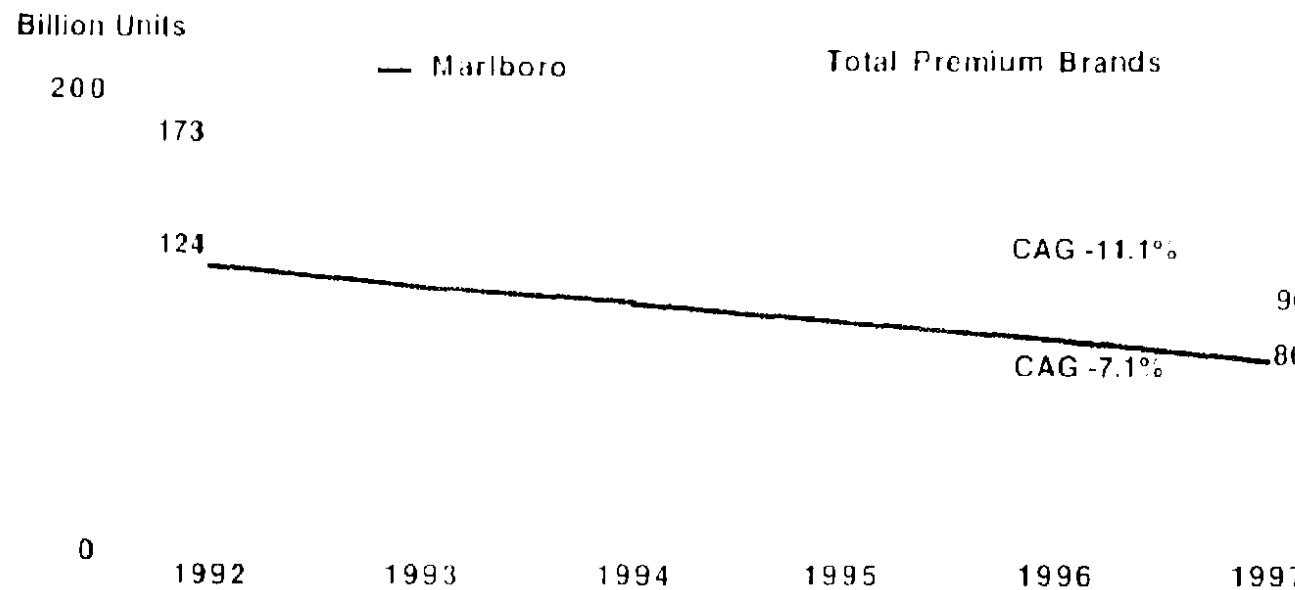


**PM-USA**  
1993-97 FYP Pres. 2/10/93

2073445507

# Current Downside

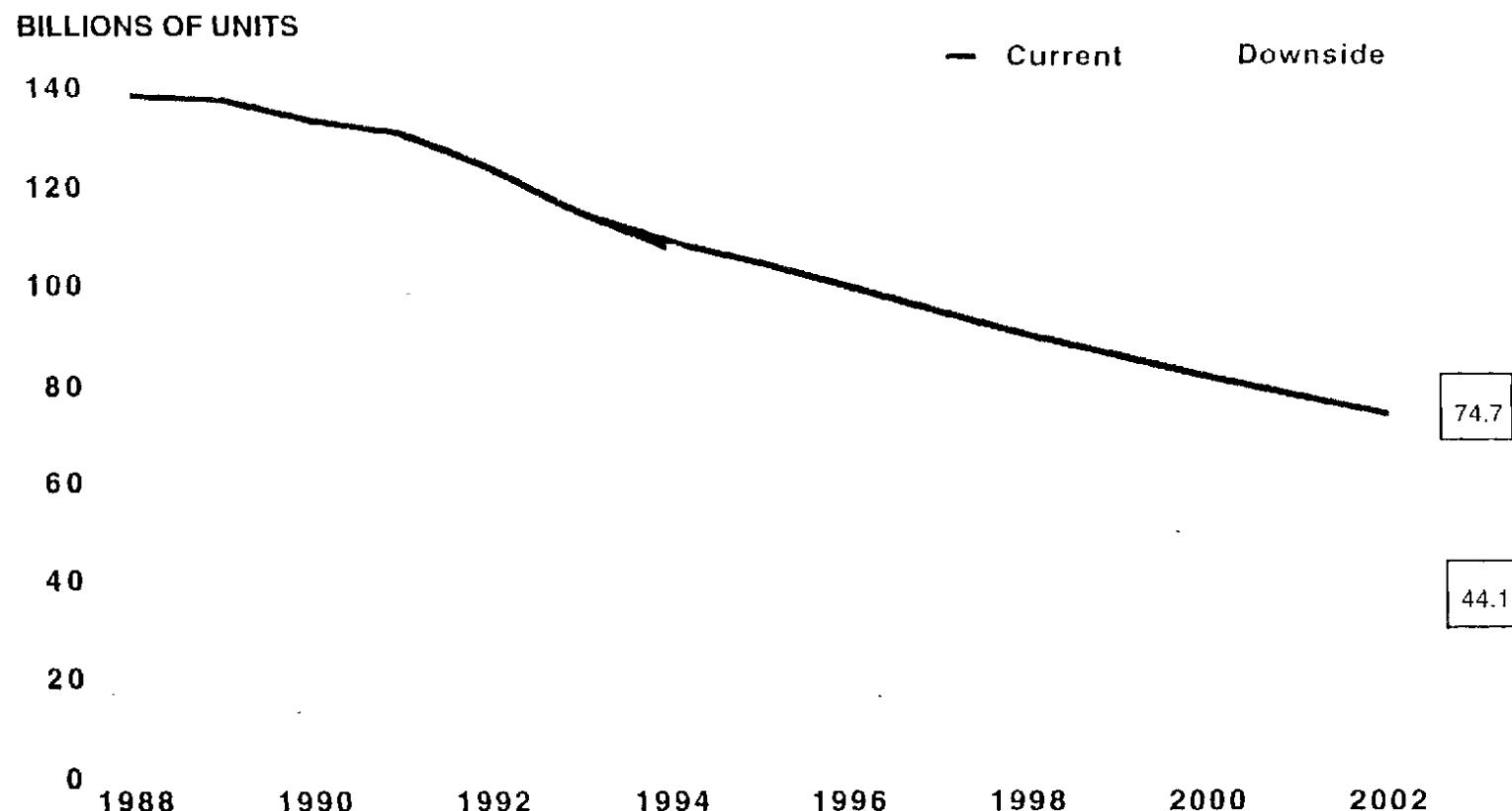
## PM-USA Premium Volume Performance



**PM-USA**  
1991-97 FYP Pres. 2-10-97

2073445508

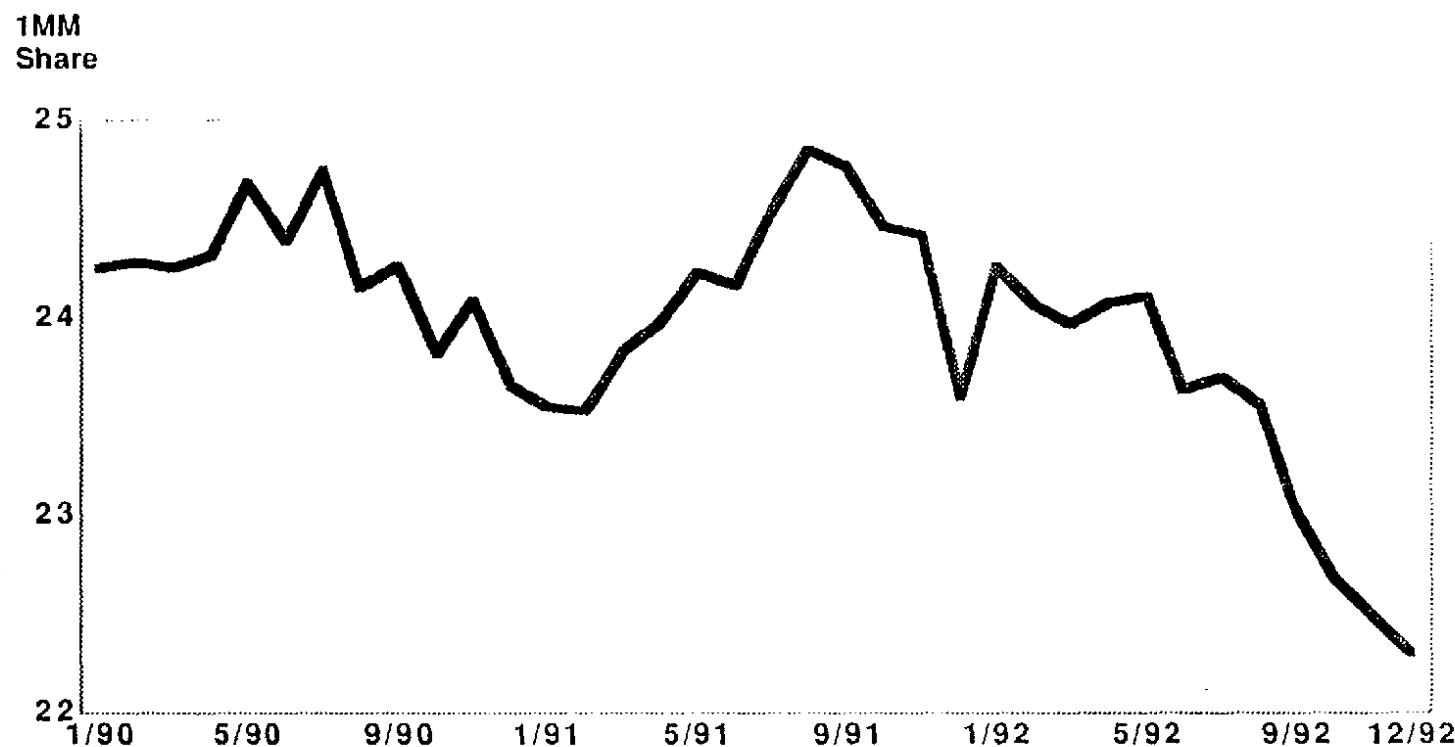
## MARLBORO VOLUME TRENDS 1988-2002



**PM-USA**  
1993-97 FYP Pres. 2/10/93

2073445509

**Marlboro's decline is periodically halted by promotions, new introductions and other reductions in the value gap with discount.**

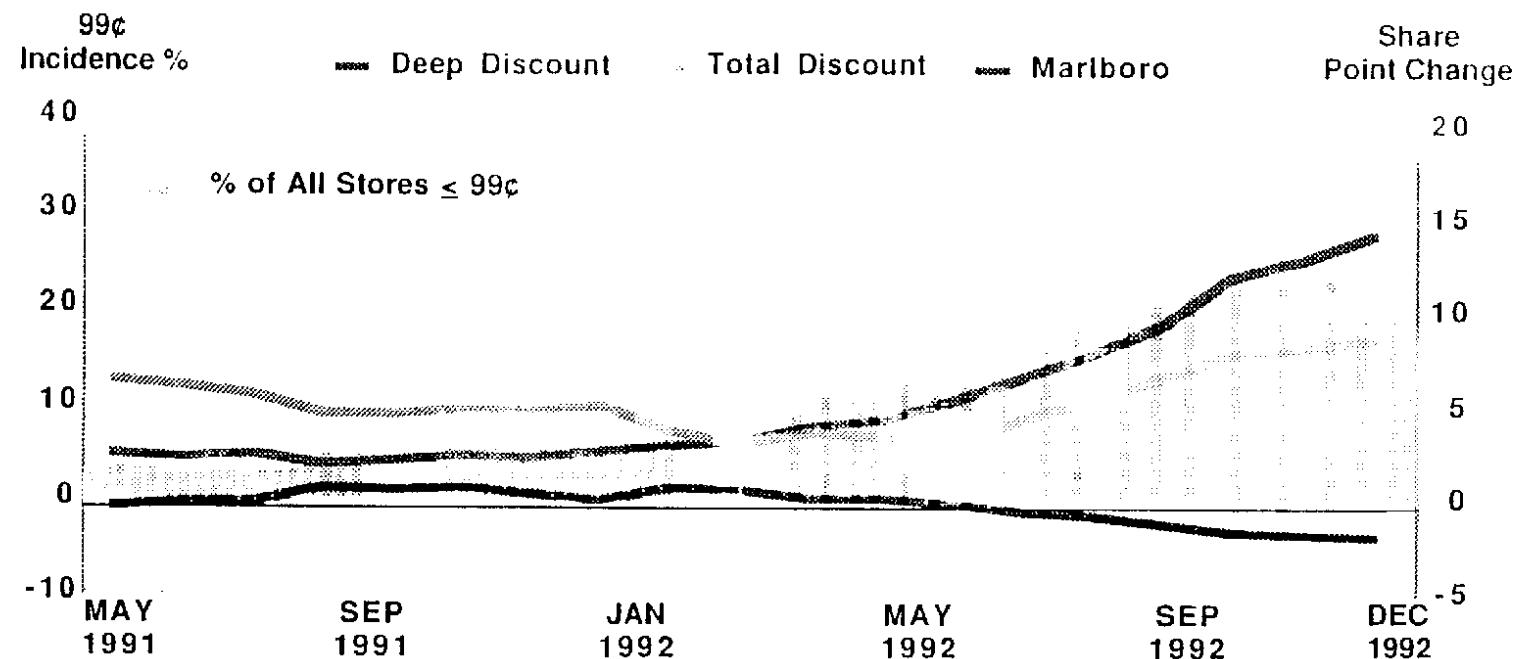


Source: New Nielsen Monthly Data

**PM-USA**  
1993-97 FYP Pres. 2/10/93 #2

2073445510

## Marlboro Share Decline is a function of an increase in 99¢ Pricing Incidence

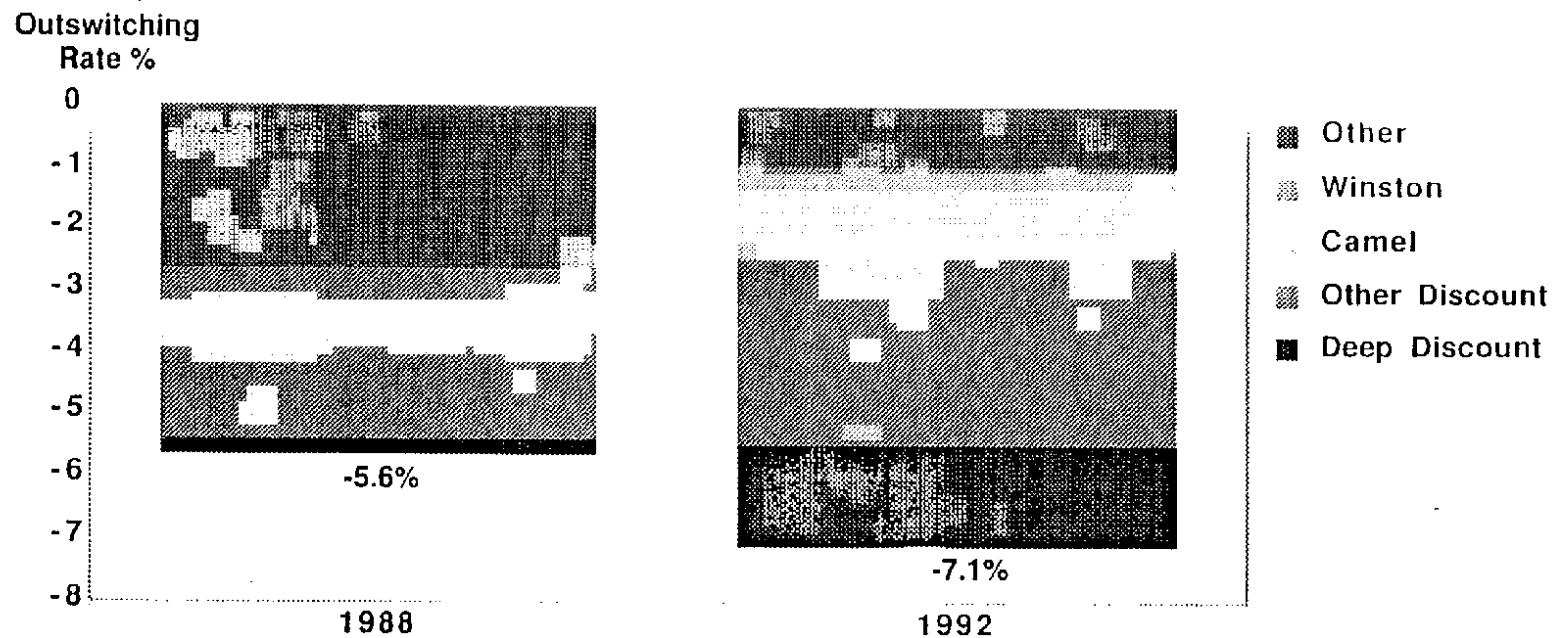


Source: Nielsen 1MM/Retail Pricing Sweeps

**PM-USA**  
1993-97 FYP Pres. 2/10/93

2073445511

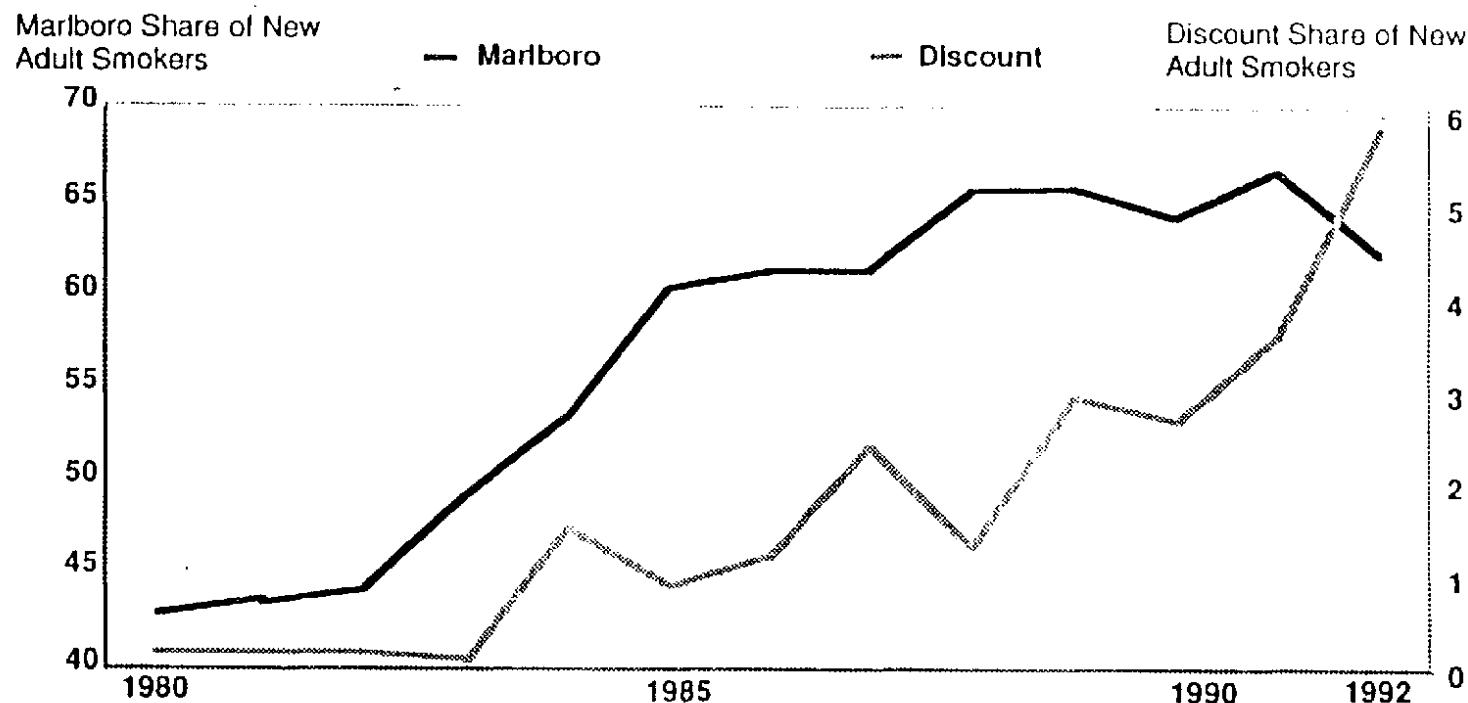
**Marlboro's outswitching rate has increased since 1988, with deep discounts accounting for most of the additional loss and total discounts accounting for 70% of 1992 losses.**



**PM-USA**  
1993-97 FYP Pres. 2/10/93

2073445512

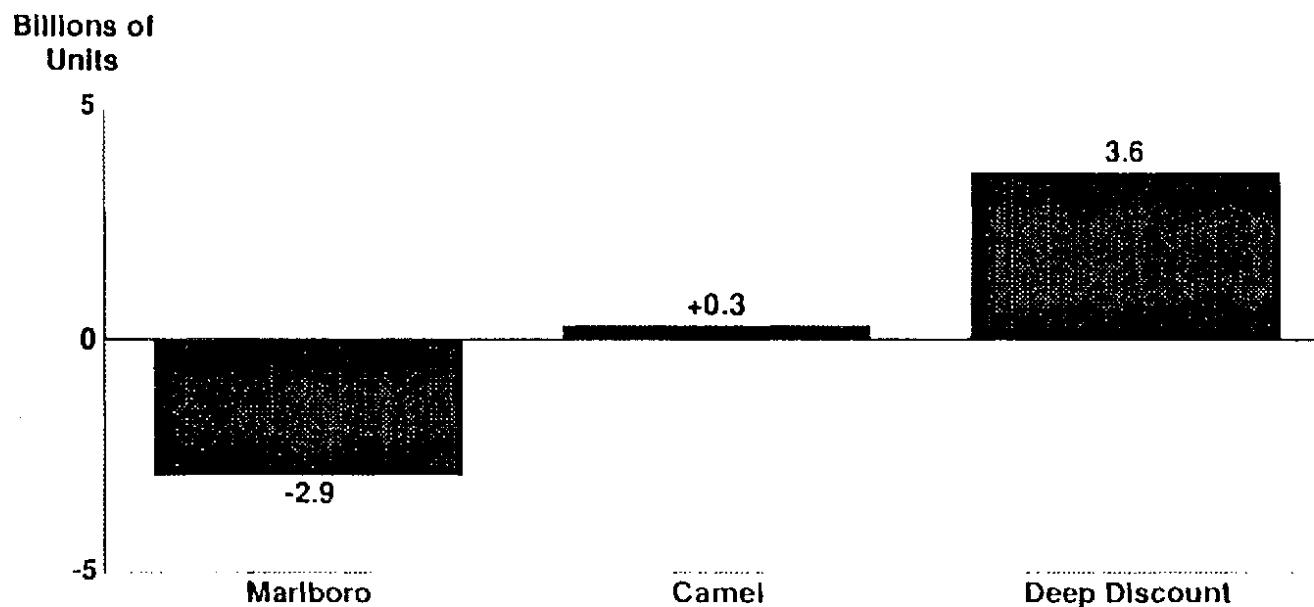
**As discount's share of new adult smokers rises,  
Marlboro's share is weakening.**



**PM-USA**  
1993-97 FYP Pres. 2/10/93

2073445513

**Among 18-24 year old smokers, deep discount brands have gained 3.6 billion units. Over the past year, Marlboro has lost 2.9 billion.**

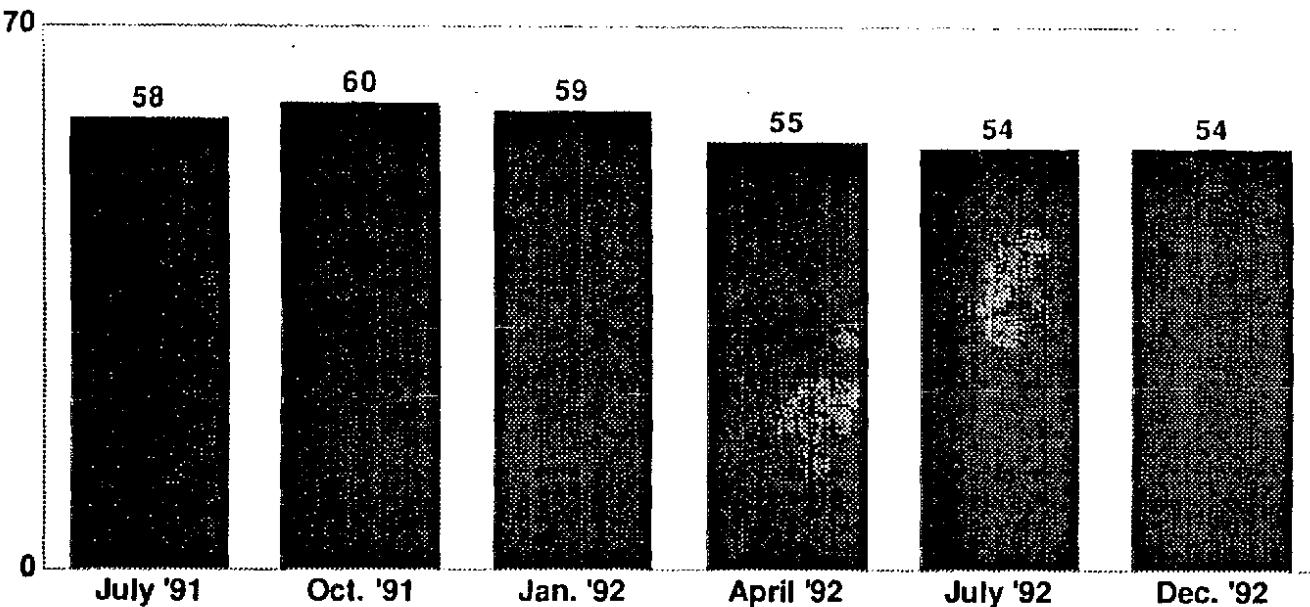


**PM-USA**  
1993-97 FYP #5

2073445514

**Marlboro's share of 18-24 volume is off 5 percent since January 1992.**

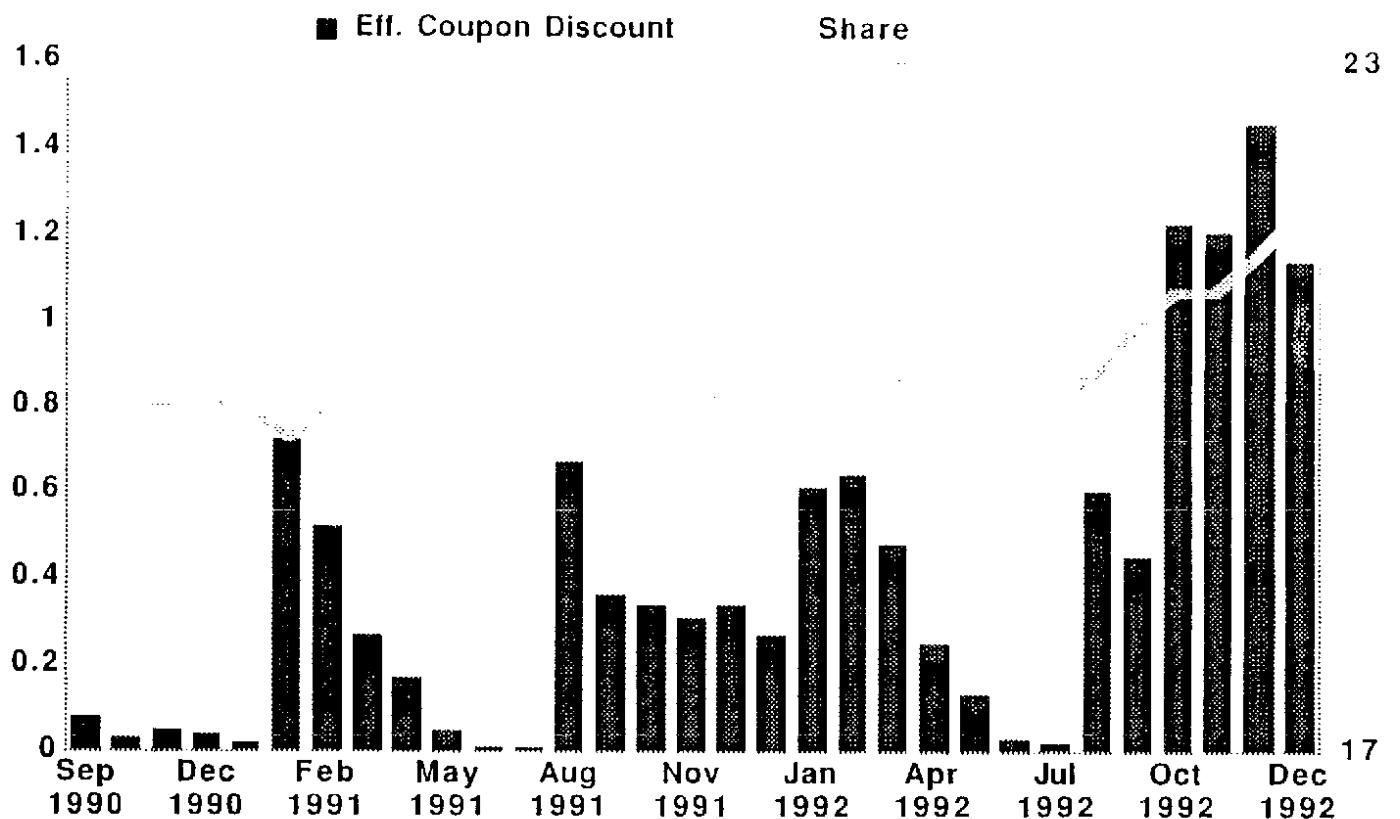
Share of 18-24  
smoker volume  
(3MM)



**PM-USA**  
1993-97 FYP #5

2073445515

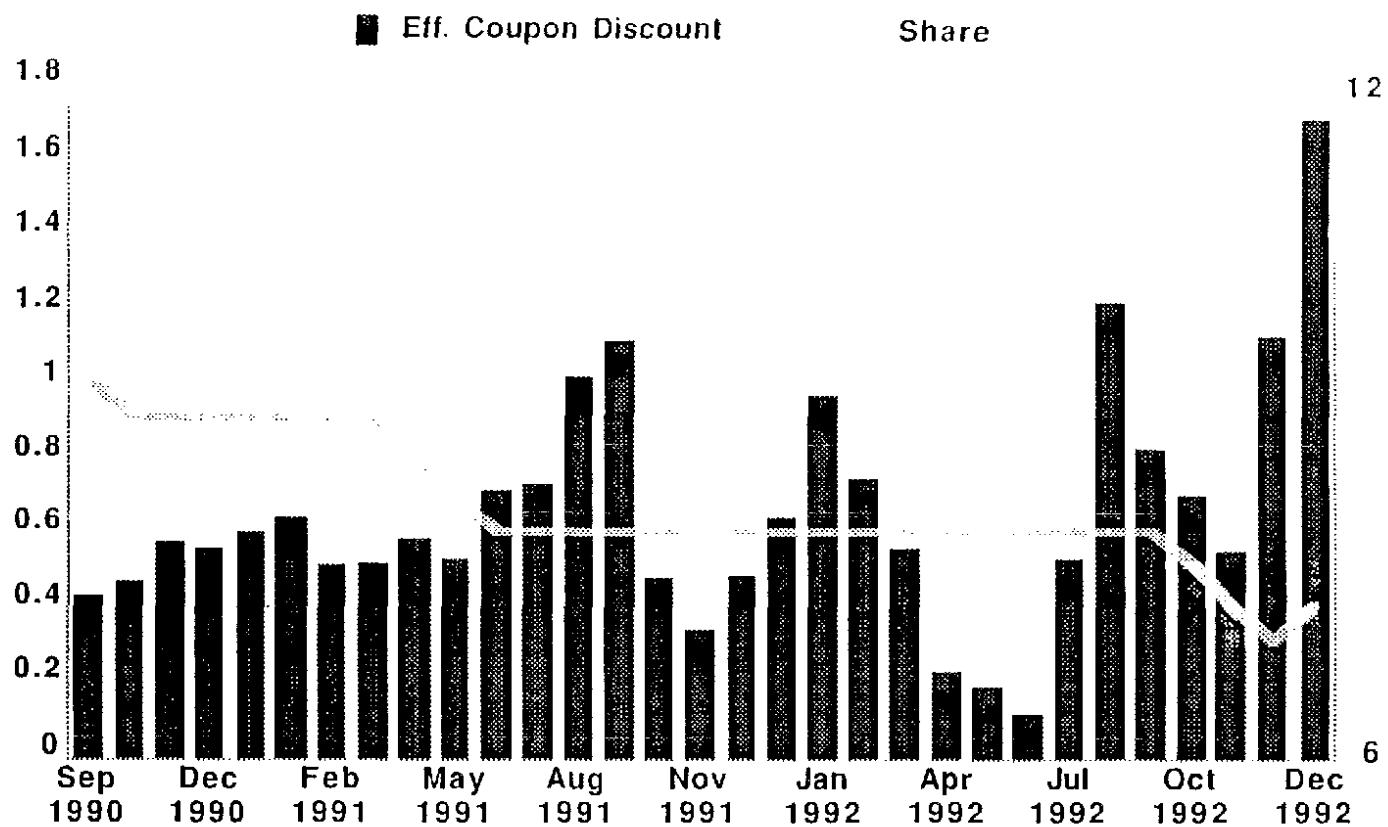
## Marlboro responds strongly to promotion



**PM-USA**  
SYP Pres. 1/21/93 #2

2073445516

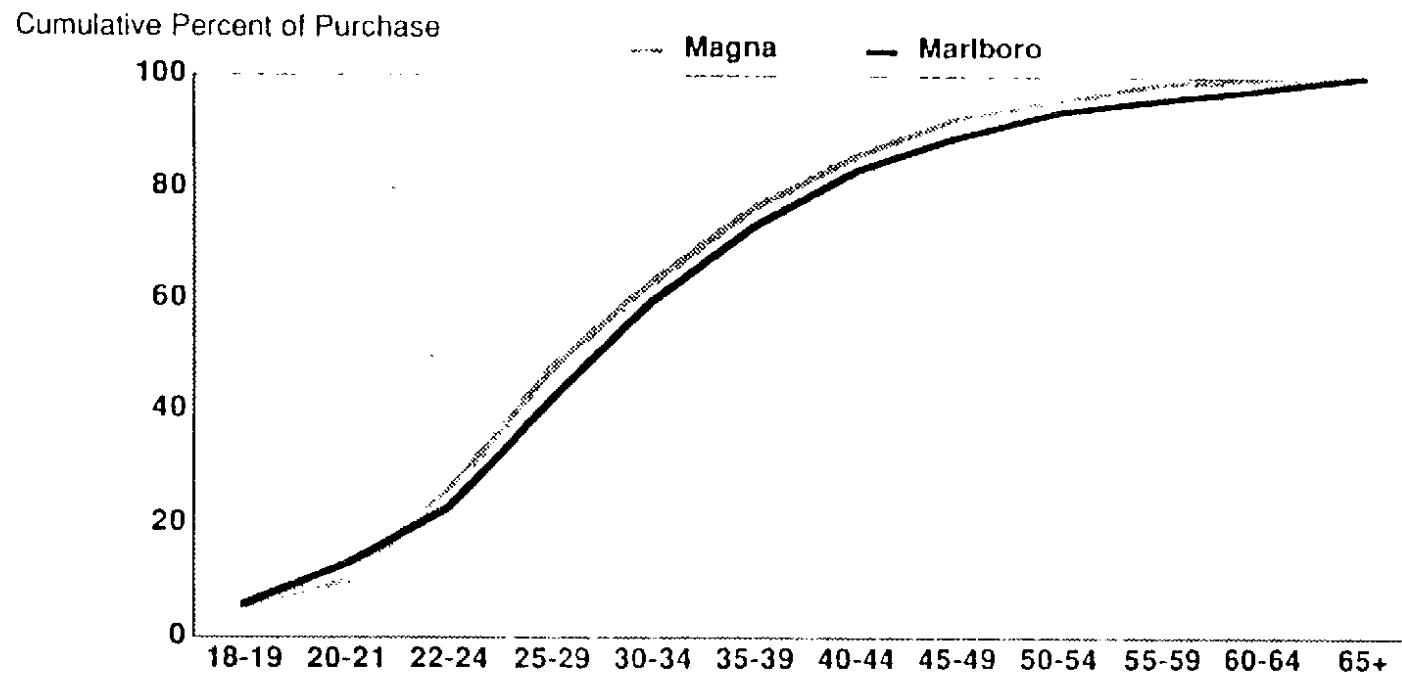
## Winston has become largely insensitive to promotion



**PM-USA**  
5YP Pres. 1/21/93 #2

2073445517

**Magna's age profile is as young as Marlboro's.**



**PM-USA**  
1993-97 FYP Pres. 2/10/93

2073445518

## **Current Downside Trends into the Future**

- Total cigarette volume will continue to decline 2-3% per year
- Premium prices will continue to rise at twice the rate of personal disposable income
- The gap between premium prices and minimum legal price will continue to grow
- Smokers will continue to switch to lower-priced cigarettes in significant numbers

**PM-USA**  
FYP Pres. 2/10/93 #4

2073445519

## **Current Downside PMUSA Trends into the Future**

- PM-USA's overall share of market will be flat
- PM-USA's premium volume will decline 11.1%  
CAG through 1997
- PM-USA's IFO growth will decline each year
- All these trends will worsen over the plan period

**PM-USA**  
FYP Pres. 2/10/93 #4

2073445520

# Conclusions

- **Discount growth is a long-term change in industry and PMUSA is in a weak position**
- **Current Strategy delivers acceptable IFO growth to PMUSA and RJR, but significantly higher IFO growth and lower share of discount category for B&W.**
- **Current downside doesn't deliver discount profit, acceptable position in market and IFO growth**

# Alternatives

- Hope for hyperinflation or hypertaxation
- Accelerate premium pricing to reach (price-inelastic) premium core
- Drop premium prices to slow losses to discount
- Accelerate our market share growth and compete in discount using value brands with trademark equity

**PM-USA**  
FYP Pres. 2/10/93 #4

2073445522

## Accelerate Premium Pricing

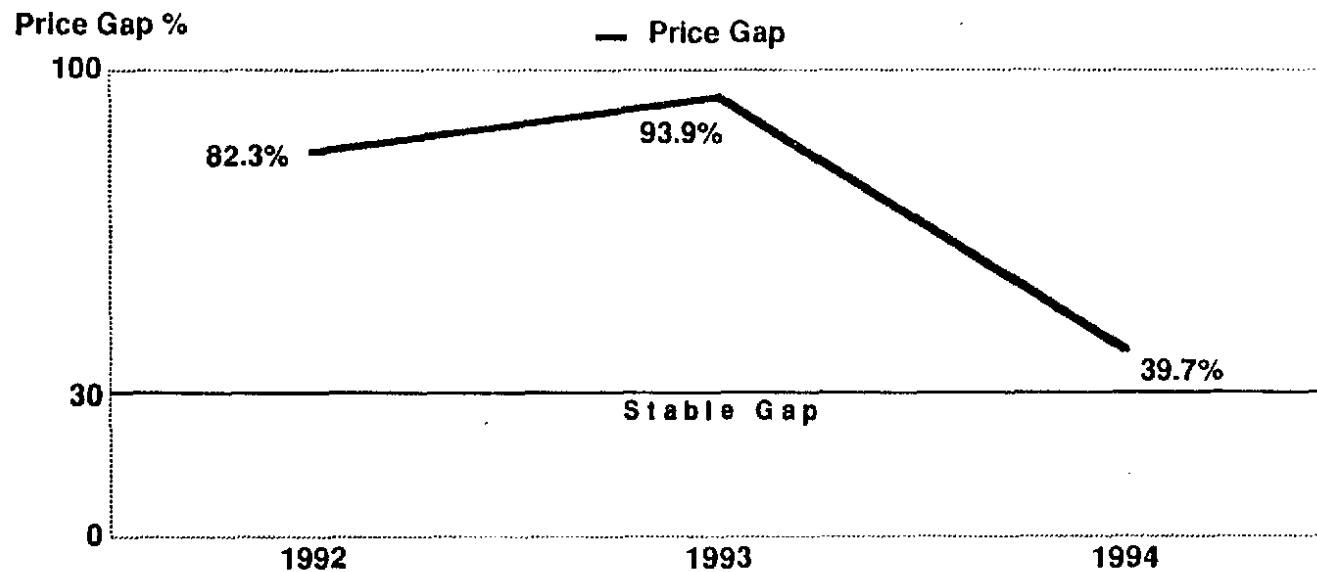
- Premise: Some numbers of smokers will pay \$5.00 or more per pack to buy Marlboro
  - Local income levels are strong predictors of discount growth
  - If enough numbers of the franchise will pay a high enough price, we can make more absolute dollars on fewer units
  - By definition, this group will also accept large absolute dollar increases (\$25 per M) needed to grow our margins
  - Going in that direction anyway, this approach maximizes income along the way

**BUT: IF CORE GROUP IS TOO SMALL, THE TRADEMARKS ARE LOST**

**PM-USA**  
1993.97 FYP Rev. 2/10/91

2073445523

**A \$15 per thousand price decrease on premium brands on Jan. 1, 1994 will lower the price gap to 39.7%, which is near the premium share stable gap of 30%.**



**PM-USA**  
1993-97 FYP #5

2073445524

## Drop Price

**Assumptions:**

**PM SOP +2.0%**

**PM SOD Growth 40%**

|                  | Price Increase |          | Effective<br>Retail Price |              |         |
|------------------|----------------|----------|---------------------------|--------------|---------|
|                  | Premium        | Discount | Premium                   | Discount     | New Gap |
| 1992             | \$6.00         | (\$3.00) | \$1.91                    | \$1.05       | 82.3%   |
| 1993             | \$6.00         | -        | \$2.11                    | \$1.09       | 93.9%   |
| 1994             | (\$15.00)      | \$4.00   | \$1.88                    | \$1.35       | 39.7%   |
| 1995             | \$4.50         | \$2.50   | \$2.03                    | \$1.45       | 40.0%   |
| 1996             | \$4.50         | \$2.75   | \$2.28                    | \$1.67       | 37.0%   |
| 1997             | \$5.00         | \$3.00   | \$2.44                    | \$1.78       | 36.9%   |
| <b>CAG 92-97</b> |                |          | <b>5.1%</b>               | <b>11.2%</b> |         |

**PM-USA**  
1993-97 FYP Pres. 2/10/93 #2

2073445525

## Drop Price

|                        | <u>1992</u> | <u>1997</u> | <u>CAG</u> |
|------------------------|-------------|-------------|------------|
| <b>Industry Volume</b> | 506.8       | 442.0       | -2.7%      |
| <b>Premium</b>         | 353.7       | 259.6       | -6.0%      |
| <b>Discount</b>        | 153.1       | 182.4       | +3.6%      |
| <b>Discount Share</b>  | 30.2%       | 41.3%       |            |
| <br>                   |             |             |            |
| <b>PM-USA Volume</b>   | 214.3       | 204.8       | -0.9%      |
| <b>Premium</b>         | 172.8       | 152.7       | -2.4%      |
| <b>Discount</b>        | 41.5        | 52.1        | +4.7%      |

**PM-USA**  
1993-97 FYP Pres. 2/10/93 #2

2073445526

# Drop Price

## Income From Operations

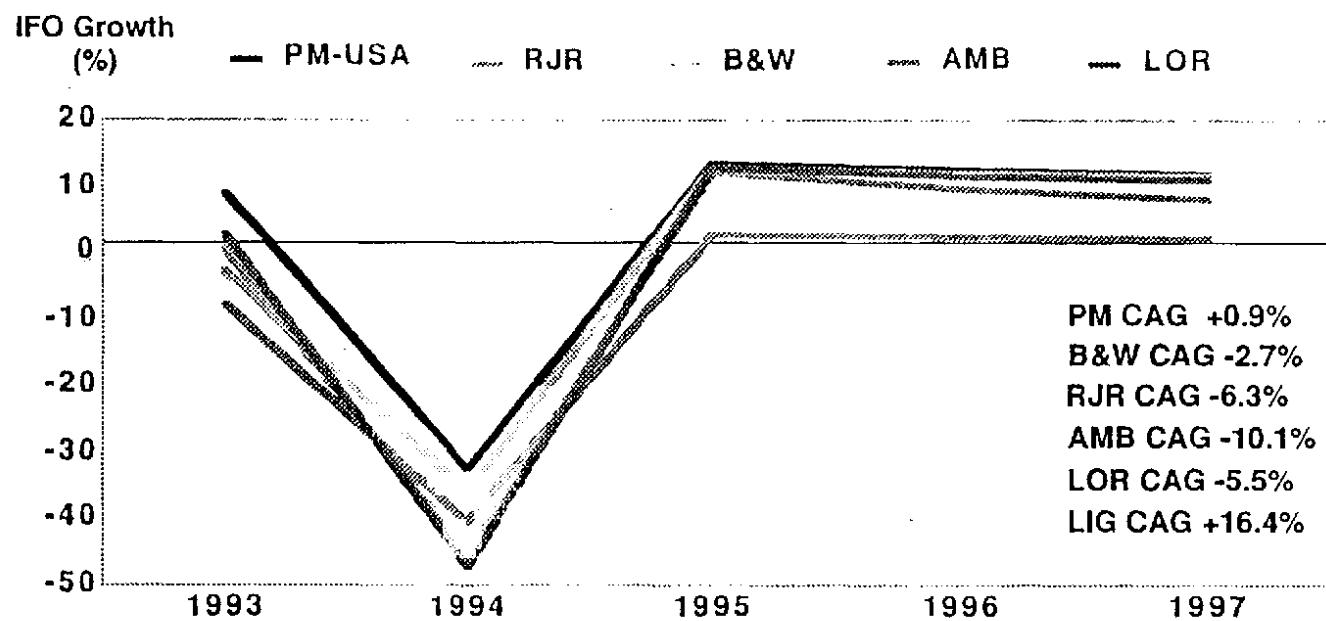
|           | <u>Drop Price</u> | <u>Downside</u> | <u>Difference</u> |
|-----------|-------------------|-----------------|-------------------|
| 1992      | \$5185            | \$5185          | -                 |
| 1993      | 5655              | 5655            | -                 |
| 1994      | 3802              | 5827            | (2025)            |
| 1995      | 4316              | 5870            | (1554)            |
| 1996      | 4856              | 5874            | (1018)            |
| 1997      | 5428              | 5887            | (459)             |
| CAG 92-97 | 0.9%              | 2.6%            |                   |

**PM-USA**  
1993-97 FYP Pres. 2/10/93 #2

2073445527

# Drop Price

## Annual IFO Growth

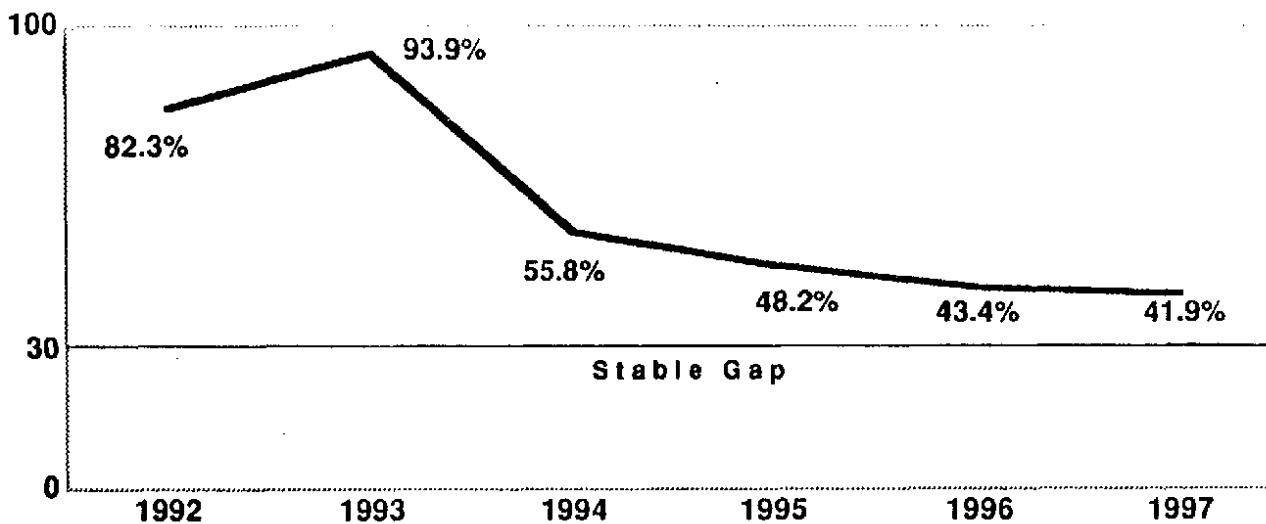


2073445528

**PM-USA**  
1993-97 FYP Pres. 2/10/93

**Absorbing the 1994 FET increase and  
freezing premium prices for two years  
will gradually reduce the price gap.**

Price Gap %



2073445529

**PM-USA**  
1993-97 FYP #5

Assumptions:  
PM SOP +2.0%  
PM SOD Growth 40%

## Price Freeze

|           | Price Increase |          | Effective<br>Retail Price |          |  | New Gap |
|-----------|----------------|----------|---------------------------|----------|--|---------|
|           | Premium        | Discount | Premium                   | Discount |  |         |
| 1992      | \$6.00         | (\$3.65) | \$1.91                    | \$1.05   |  | 82.3%   |
| 1993      | \$6.00         | -        | \$2.11                    | \$1.09   |  | 93.9%   |
| 1994      | (\$4.00)       | \$4.00   | \$2.16                    | \$1.39   |  | 55.8%   |
| 1995      | -              | \$2.50   | \$2.20                    | \$1.48   |  | 48.2%   |
| 1996      | \$4.50         | \$2.75   | \$2.44                    | \$1.70   |  | 43.4%   |
| 1997      | \$4.75         | \$3.00   | \$2.60                    | \$1.83   |  | 41.9%   |
| CAG 92-97 |                |          | 9.6%                      | 13.0%    |  |         |

2073445530

**PM-USA**  
1993-97 FYP Pres. 2/10/93 #2

## Price Freeze

|                        | <u>1992</u> | <u>1997</u> | <u>CAG</u> |
|------------------------|-------------|-------------|------------|
| <b>Industry Volume</b> | 506.8       | 442.0       | -2.7%      |
| <b>Premium</b>         | 353.7       | 230.2       | -8.7%      |
| <b>Discount</b>        | 153.1       | 211.8       | +6.7%      |
| <b>Discount Share</b>  | 30.2%       | 47.9%       |            |
| <br>                   |             |             |            |
| <b>PM-USA Volume</b>   | 214.3       | 199.3       | -1.4%      |
| <b>Premium</b>         | 172.8       | 135.4       | -4.8%      |
| <b>Discount</b>        | 41.5        | 63.9        | +9.0%      |

2073445531

**PM-USA**  
1993-97 FYP Pres. 2/10/93 #2

# Price Freeze

## Income From Operations

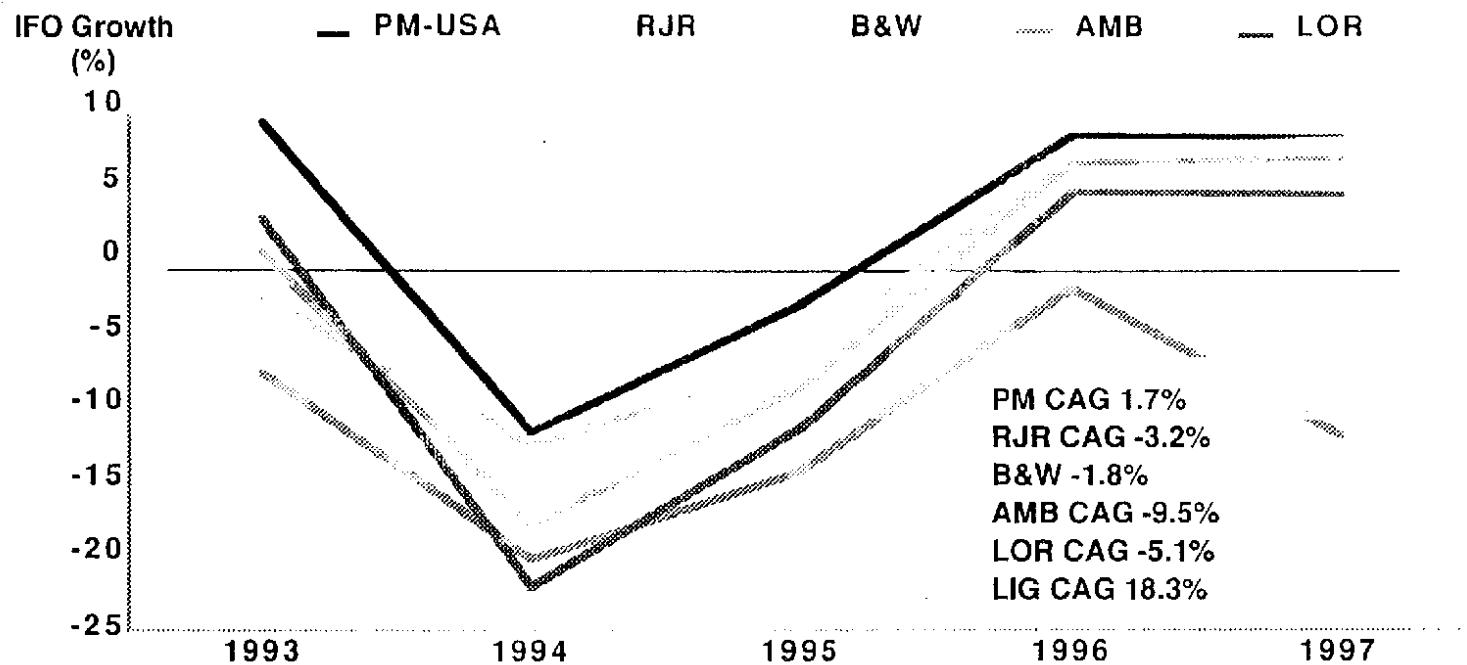
|                  | <u>Price Freeze</u> | <u>Downside</u> | <u>Difference</u> |
|------------------|---------------------|-----------------|-------------------|
| 1992             | 5185                | 5185            | -                 |
| 1993             | 5655                | 5655            | -                 |
| 1994             | 4983                | 5827            | (844)             |
| 1995             | 4821                | 5870            | (1049)            |
| 1996             | 5223                | 5874            | (651)             |
| 1997             | 5649                | 5887            | (238)             |
| <b>CAG 92-97</b> | <b>1.7%</b>         | <b>2.6%</b>     |                   |

MESSHLOC

**PM-USA**  
FYP Pres 2/10/93 #2

# Price Freeze

## Annual IFO Growth



2073445532

**PM-USA**  
1993-97 FYP Pres. 2/10/93

# PMUSA Discount Pricing Levers

- Further reduce premium decline rates below competitors' premium
- Increase our share of discount growth
- Moderate premium price increases

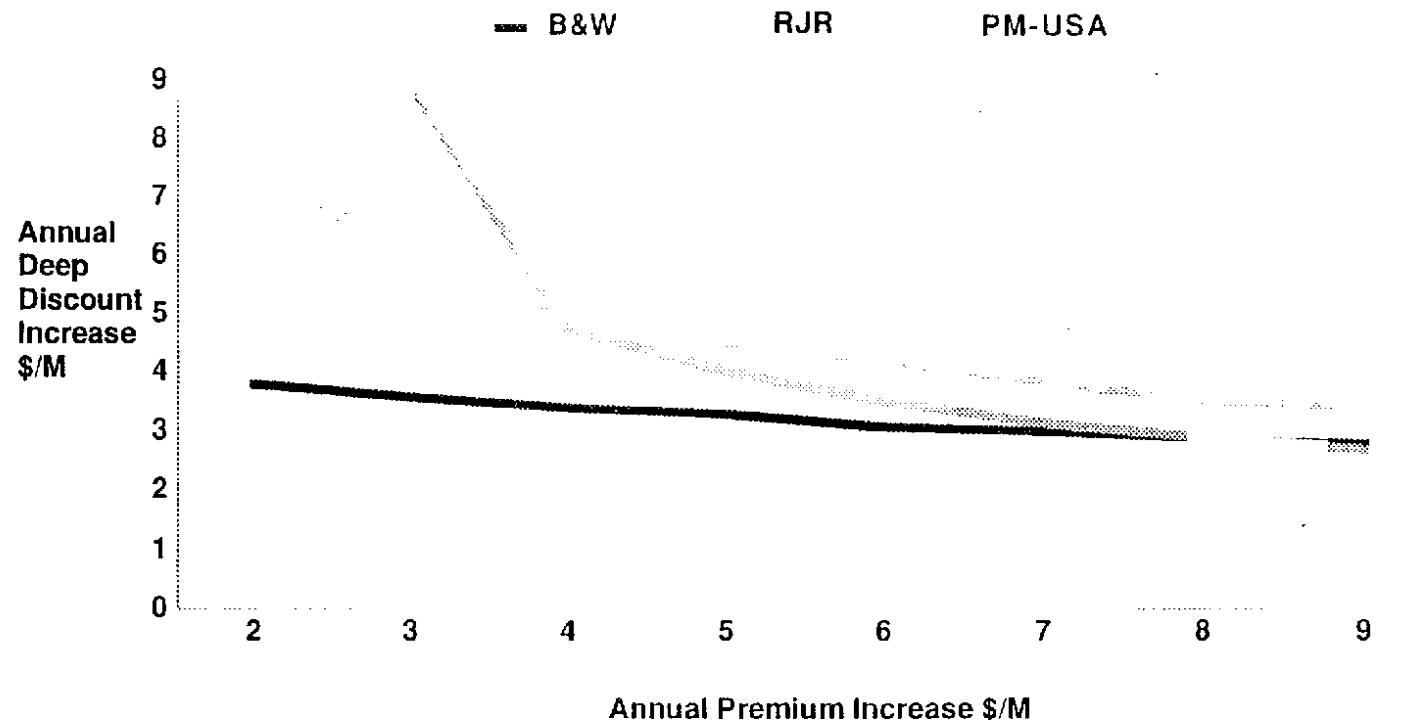
**PM-USA**  
1993-97 FYP Pres. 2/10/93

2073445533

# Accelerate Market Share Growth

- Need to exceed 1 share point growth annually by:
  - Increasing annual premium category growth above 1.6 share points
  - Increasing share of discount growth to over 50%

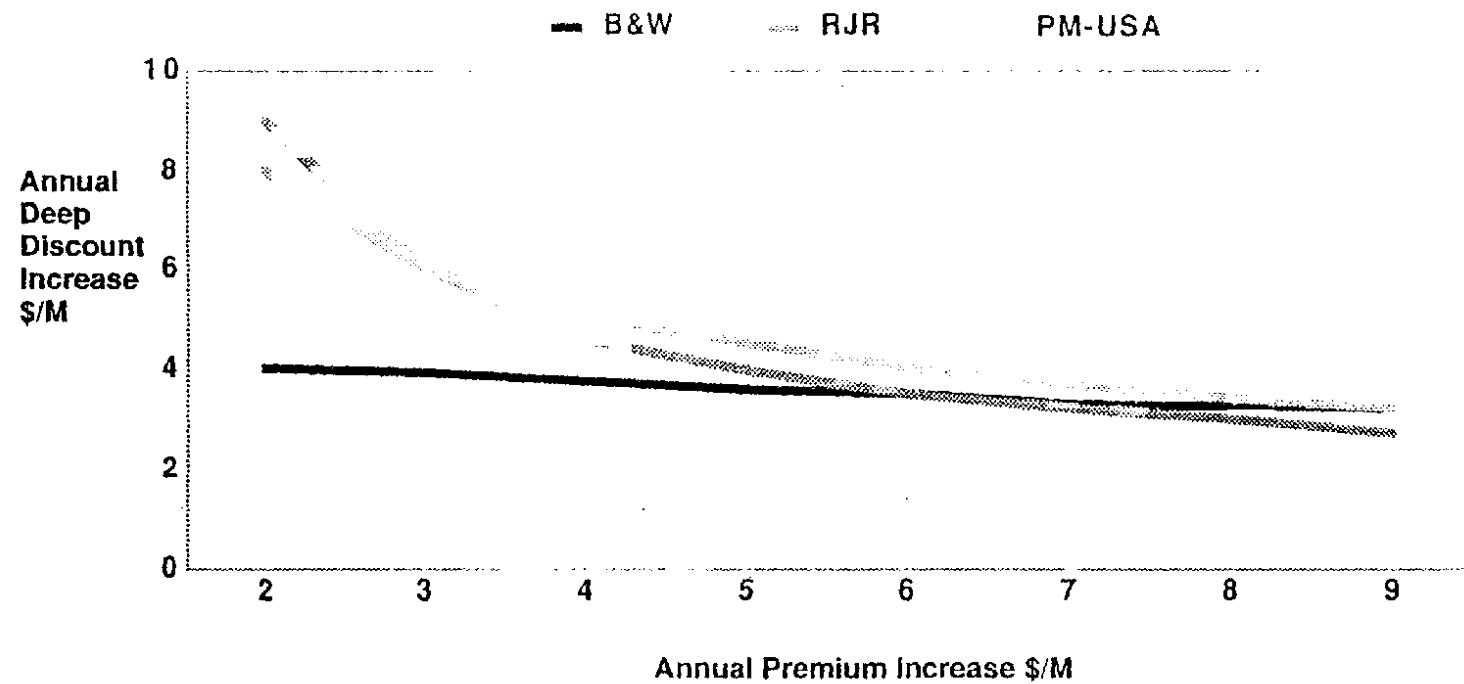
At 40% of Discount Growth, PM-USA requires more pricing than RJR and B&W to meet growth objectives.



**PM-USA**  
1993-97 FYP Pres. 2/10/93

2073445535

At 50% of Discount Growth, PM-USA's Pricing needs approach RJR's and B&W's to meet growth objectives.



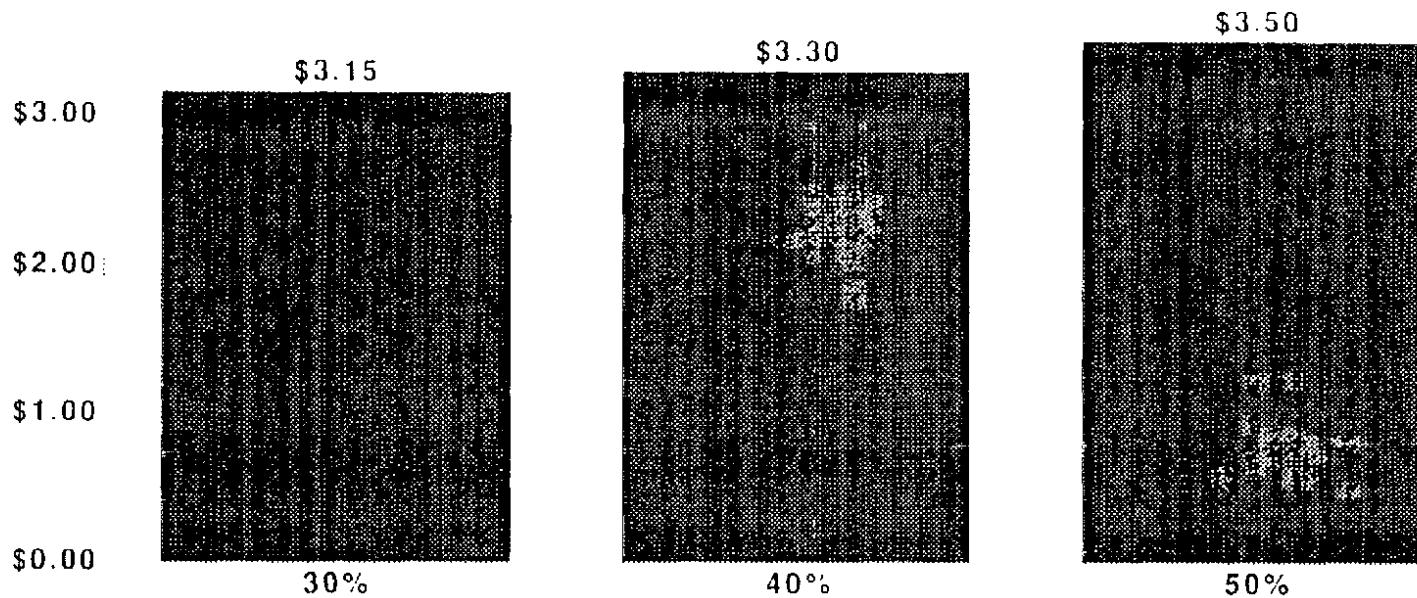
2073445536

**PM-USA**  
1993-97 FYP Pres. 2/10/93

## Discount Pricing to Give B&W 5% CAG 92-97

Annual Discount  
Price Increase

\$4.00



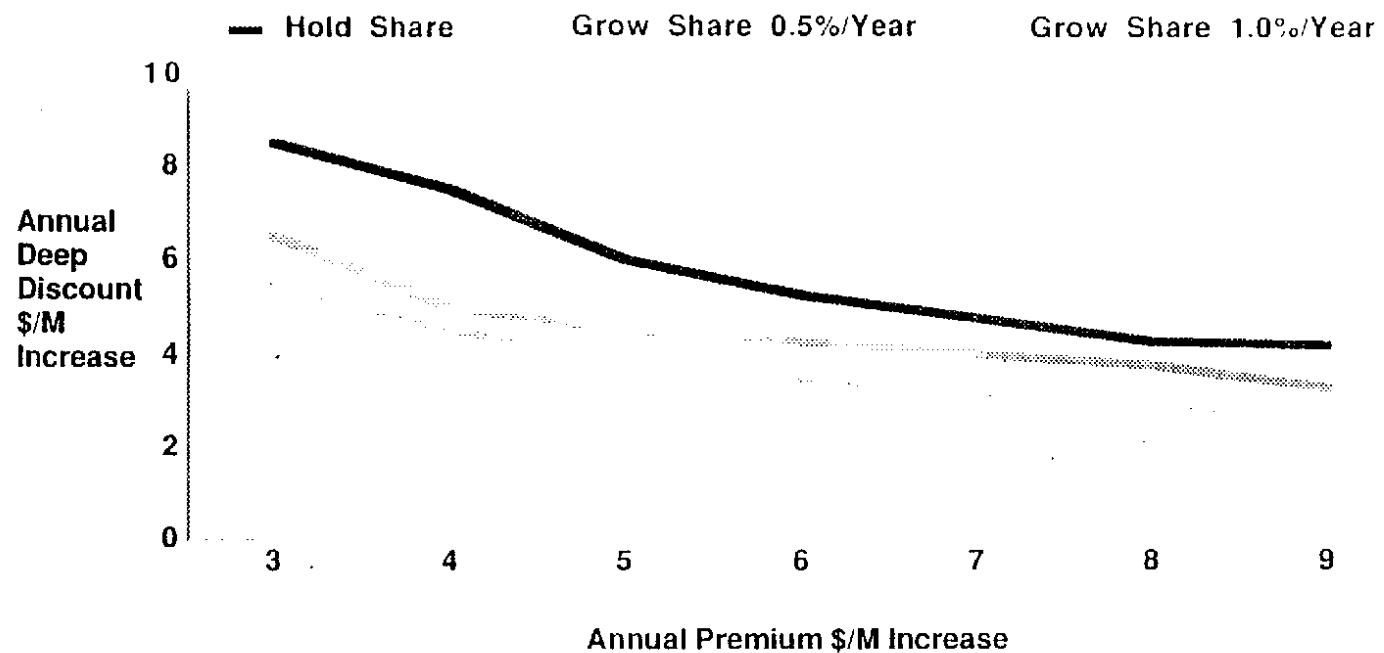
## PM Share of Discount Growth

Assumes: PM Share of Premium +1.6 year  
Premium Pricing \$6.00

**PM-USA**  
FYP Pres. 1 21 93

2073445537

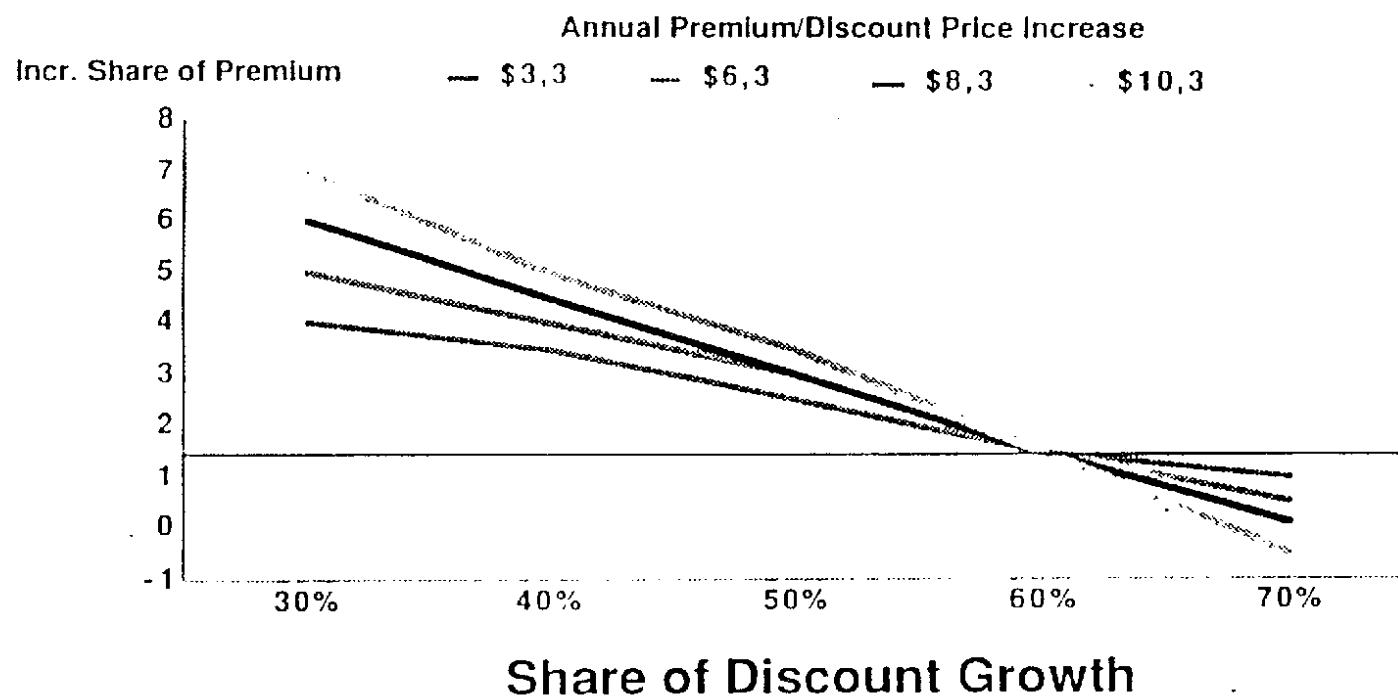
## Annual Pricing Required for PM-USA to deliver 7.5% IFO growth



**PM-USA**  
1993-97 FYP Pres. 2/10/93

2073445538

## Performance Required to Grow One SOM/Year



FYP Pres 1/21/9

2073445539

# PMUSA SWOT

## Strengths

- Marlboro
- Trademarks
- SOES
- Scale (income, marketing and sales, R&D)
- Market share
- Low Cost
- Retail Presence

## Weaknesses

- Pricing drives IFO growth
- Weak discount trademarks
- Price increases above DPI
- Inferior market share in only growing segment of industry
- Load

## Opportunities

- Weak '92 IFO of competitors
- Weak premium trademarks of competitors

## Threats

- Accelerating growth in deep discount
- RJR/B&W strength in discount
- Market access of all competitors
- Political-social assaults on smoking

**PM-USA**  
FYP Pres. 2/10/93 #4

2073445540

## **1993 - 97 Alternative Strategy**

- Enhance equity value of premium trademarks
- Capture over 50% of discount growth.
- Bring trademarks to bear in lower price tiers to insure growth (Value Line Extensions and Brands)
- Never be undersold, especially by B&W
- Change the distribution system

**PM-USA**  
FYP Pres. 2/10/93 #4

2073445541

## **Marketing Strategy (Alternate Strategy)**

- Defend premium trademarks from price erosion using promotions.
- Line extend premium trademarks into sub premium price tier.
- Launch new value brands with product/packaging characteristics designed to build base franchise in lower price tier.
- Deny lowest price position to every competitor using branded product.
- Overall share growth and lead positioning in growth segment are paramount goals.

**PM-USA**  
1993-97 FYP #3

2073445542

## **Strategic Business Imperatives**

- Protect long-term viability of our business by growing our total share of market
- Preserve existing trademarks
- Inject trademark value into discount segment
- Preserve our cash flow
- Assure stable and reliable IFO growth over the entire plan period

## **Operational Meaning**

- Take larger share of growing segments (discount)
- Use increase marketing spending/lower premium price increase to mitigate price gaps with discount
- Use line extensions and product attributes that add value to lower priced brands
- Maintain IFO at least 95% of 1992 level under all circumstances
- Lower IFO growth to a level necessary to execute four previous imperatives

**PM-USA**  
1993-97 FYP Pres. 2/10/93

2073445543

## Alternate Strategy Share Targets

|   | <u>1992</u> | <u>1997</u> | <u>Change</u> |
|---|-------------|-------------|---------------|
| Total PM-USA Share                      | 42.3%       | 44.3%       | +2.0 pp       |
| Total PM-USA Share of Premium Category  | 48.8%       | 53.6%       | +4.8 pp       |
| Total PM-USA Share of Discount Category | 27.1%       | 39.3%       | +12.2 pp      |
| Discount Share of PM-USA                | 19.4%       | 57.1%       | +37.7 pp      |

**PM-USA**  
1993-97 FYP Pres 2/10 93 #2

2073445544

## Alternate Strategy

|                        | <u>1992</u> | <u>1997</u> | <u>CAG</u> |
|------------------------|-------------|-------------|------------|
| <b>Industry Volume</b> | 506.8       | 442.0       | -2.7%      |
| <b>Premium</b>         | 353.7       | 156.7       | -15.0%     |
| <b>Discount</b>        | 153.1       | 285.3       | +13.2%     |
| <b>Discount Share</b>  | 30.2%       | 64.5%       |            |
| <br>                   |             |             |            |
| <b>PM-USA Volume</b>   | 214.3       | 196.0       | -1.8%      |
| <b>Premium</b>         | 172.8       | 84.0        | -13.4%     |
| <b>Value Brands</b>    | 18.4        | 65.5        | +28.9%     |
| <b>Deep Discount</b>   | 23.1        | 46.5        | +15.0%     |

**PM-USA**  
1993-97 FYP Pres. 2/10/93 #2

2073445545

# Alternate Strategy

**Assumptions:**

**PM SOP +1.0%**

**PM SOD Growth 53%**

|      | Price Increase |                 |           | Effective Retail Price |           |         |
|------|----------------|-----------------|-----------|------------------------|-----------|---------|
|      | Premium        | Value Brands*** | Deep Disc | Premium*               | Deep Disc | New Gap |
| 1992 | \$6.00         | -               | (\$3.65)  | \$1.91                 | \$1.05    | 82.3%   |
| 1993 | \$6.00         | 6.00            | \$6.00    | \$2.23                 | \$1.28    | 73.8%   |
| 1994 | \$8.00         | 5.25            | \$2.00**  | \$2.56                 | \$1.50    | 71.1%   |
| 1995 | \$9.50         | 5.50            | \$2.00    | \$2.82                 | \$1.59    | 76.7%   |
| 1996 | \$11.00        | 5.50            | \$2.00    | \$3.21                 | \$1.81    | 77.3%   |
| 1997 | \$12.50        | 5.50            | \$2.00    | \$3.55                 | \$1.92    | 85.0%   |

\* Value Brands' Retail Price 20% above Deep Discount

\*\* Off invoice allowance increased \$4.00/thous

\*\*\* Branded Discounts reduced to Value Brand price level Jan 1, 1994

**PM-USA**

FYP Pres. 1/21/99

2073445546

# Value Brand Retail Pricing

| % Gap Above Deep Discount | Deep Discount Retail Price | Value Brand Retail Price | Deep Discount Net Contribution Per M | Value Brand Net Contribution Per M | % of Deep Discount |
|---------------------------|----------------------------|--------------------------|--------------------------------------|------------------------------------|--------------------|
| 10%                       | \$1.00                     | \$1.10                   | \$5.00                               | \$10.00                            | 100%               |
| 20%                       | \$1.00                     | \$1.20                   | \$5.00                               | \$15.00                            | 300%               |
| 30%                       | \$1.00                     | \$1.30                   | \$5.00                               | \$20.00                            | 400%               |

(Assumes comparable marketing expenses per m)

**PM-USA**  
1993-97 FYP Pres. 2/10/93

2073445547

# Deep Discount and Value Brand Price Increases

| Deep Discount Price Increase Per M | Deep Discount Retail Price | New Value Brand Price @ 20% Gap | Value Brand Price Increase Per M |
|------------------------------------|----------------------------|---------------------------------|----------------------------------|
| -----                              | \$1.00                     | \$1.20                          | -----                            |
| \$2.50                             | \$1.07                     | \$1.26                          | \$3.00                           |
| \$5.00                             | \$1.13                     | \$1.36                          | \$6.15                           |

**PM-USA**  
1993-97 IYP Rev. 2/10/93

2073445548

# Alternate Strategy

## Income From Operations

|                  | <u>PM-USA</u> | <u>Total Industry</u> | <u>Industry %Change</u> | <u>PM-USA Share of Industry</u> |        |
|------------------|---------------|-----------------------|-------------------------|---------------------------------|--------|
| 1992             | 5185          | 9450                  | 4.5%                    | 54.9%                           | 100.0% |
| 1993             | 5650          | 10122                 | 7.1%                    | 56.5%                           | 79.7%  |
| 1994             | 5443          | 9496                  | (6.4%)                  | 57.3%                           | --     |
| 1995             | 5597          | 9470                  | (0.3%)                  | 59.1%                           | --     |
| 1996             | 5899          | 9772                  | 3.2%                    | 60.4%                           | 100%   |
| 1997             | 6182          | 9890                  | 1.2%                    | 62.5%                           | 100%   |
| <b>CAG 92-97</b> | <b>3.6%</b>   | <b>0.9%</b>           |                         |                                 |        |

**PM-USA**

FYP Pres. 1/21/93

2073445549

# PM-USA Value Tier Volume

1997

|                             | <u>Current<br/>Downside</u> | <u>Alternate<br/>Strategy</u> |
|-----------------------------|-----------------------------|-------------------------------|
| <b>Value Line Extension</b> | 0.0                         | 27.0                          |
| <b>Value Brand</b>          | 3.8                         | 38.5                          |
| <b>Basic</b>                | 56.4                        | 19.3                          |
| <b>Private Label</b>        | <u>30.4</u>                 | <u>27.2</u>                   |
| <b>Total</b>                | 90.6                        | 112.0                         |

**PM-USA**  
1993-97 FYP Pres. 2/10/93 #2

2073445550

## Risks

- Price competition in deep discount flattens our IFO
- Moderate premium pricing is not competitively sustained
- Inability to inject trademark value into discount to sustain moderate price premium over discount

## Offsets

- Competitors IFO declines at double-digit rates
- Aggressive premium pricing accelerates competitors' premium volume declines without offsetting their IFO declines
- Strong trademarks have historically sustained moderate price premiums over generic products

# Competitive Reactions

## Impact on IFO

- Drop prices of premium brands
  - RJR -45%
  - B&W -36%
  - AMB -41%
  - LOR -47%
  - LIG -37%
- Drop price of branded discount to deep discount level
  - RJR -19%
  - B&W -20%
  - AMB -53%
  - LOR -5%
  - LIG -100%

**PM-USA**  
1993-97 FYP Pres. 2/10/93

2073445552

# PM Responses

- Accelerate introduction of Value Brands
- Seek alternative distribution mechanisms (direct mail, exclusive distributions)
- Freeze premium prices

**PM-USA**  
1993-97 FYP Pres. 2/10/93

2073445553

# Change the Marketplace

- Direct Mail delivery to encourage large volume purchases
- Exclusive distributorships of PM products
- Proprietary product characteristics (fire safe, heating vs. burning)

**PM-USA**  
1993-97 FYP #3

2073445554

## Scenario Comparison

|                 | Current Strategy |           | Current Downside |           | Alternate Strategy |               |
|-----------------|------------------|-----------|------------------|-----------|--------------------|---------------|
|                 | 1997             | 5 Yr. CAG | 1997             | 5 Yr. CAG | 1997               | 5 Yr. CAG     |
| Industry Volume | 442.0            | -2.7%     | 442.0            | -2.7%     | 442.0              | -2.7%         |
| Premium         | 220.1            | -9.1%     | 168.8            | -13.8%    | 156.7              | -15.0%        |
| Value Brands    | 43.3             | -10.9%    | 16.8             | -26.3%    | 78.5               | +0.3%         |
| Deep Discount   | 178.6            | +18.7%    | 256.4            | +27.6%    | 206.8              | +22.2%        |
| PM-USA Volume   | 194.2            | -1.9%     | 186.6            | -2.7%     | 196.0              | -1.8%         |
| Premium         | 125.3            | -6.2%     | 96.1             | -11.1%    | 84.0               | -13.4%        |
| Value Brands    | 9.9              | -11.7%    | 3.8              | -27.1%    | 65.5               | +28.9%        |
| Deep Discount   | 59.0             | +20.6%    | 86.7             | +30.3%    | 46.5               | +15.0%        |
| Discount Share  | 50.2%            |           | 61.8%            |           | 64.5%              | <b>PM-USA</b> |

1993-97 FYP Pres 2/10/93 #2

2073445555

# Scenario Comparison

|                        | <u>Current</u> | <u>Downside</u> | <u>Alternate</u> |
|------------------------|----------------|-----------------|------------------|
| <b>Performance Gap</b> | 7.5%           | 9.2%            | 6.9%             |

# Scenario Pricing

|                           | <u>1993</u> | <u>1994</u> | <u>1995</u> | <u>1996</u> | <u>1997</u> |
|---------------------------|-------------|-------------|-------------|-------------|-------------|
| <b>FET Increase</b>       | \$2.00      | \$4.00      |             | \$4.00      |             |
| <b>Current Strategy</b>   |             |             |             |             |             |
| Premium/Branded Disc.     | \$6.00      | \$5.25      | \$5.75      | \$6.25      | \$6.75      |
| Deep Discount             | \$6.00      | \$4.75      | \$5.25      | \$5.75      | \$6.25      |
| <b>Current Downside</b>   |             |             |             |             |             |
| Premium/Branded Disc.     | \$6.00      | \$8.00      | \$9.50      | \$11.00     | \$12.50     |
| Deep Discount             | \$6.00      | \$1.00*     | \$1.00      | \$1.00      | \$1.00      |
| <b>Alternate Strategy</b> |             |             |             |             |             |
| Premium                   | \$6.00      | \$8.00      | \$9.50      | \$11.00     | \$12.50     |
| Value Brands***           | \$6.00      | \$5.25      | \$5.50      | \$5.50      | \$5.50      |
| Deep Discount             | \$6.00      | \$2.00**    | \$2.00      | \$2.00      | \$2.00      |

\* Off invoice allowance increase \$5.00/thous

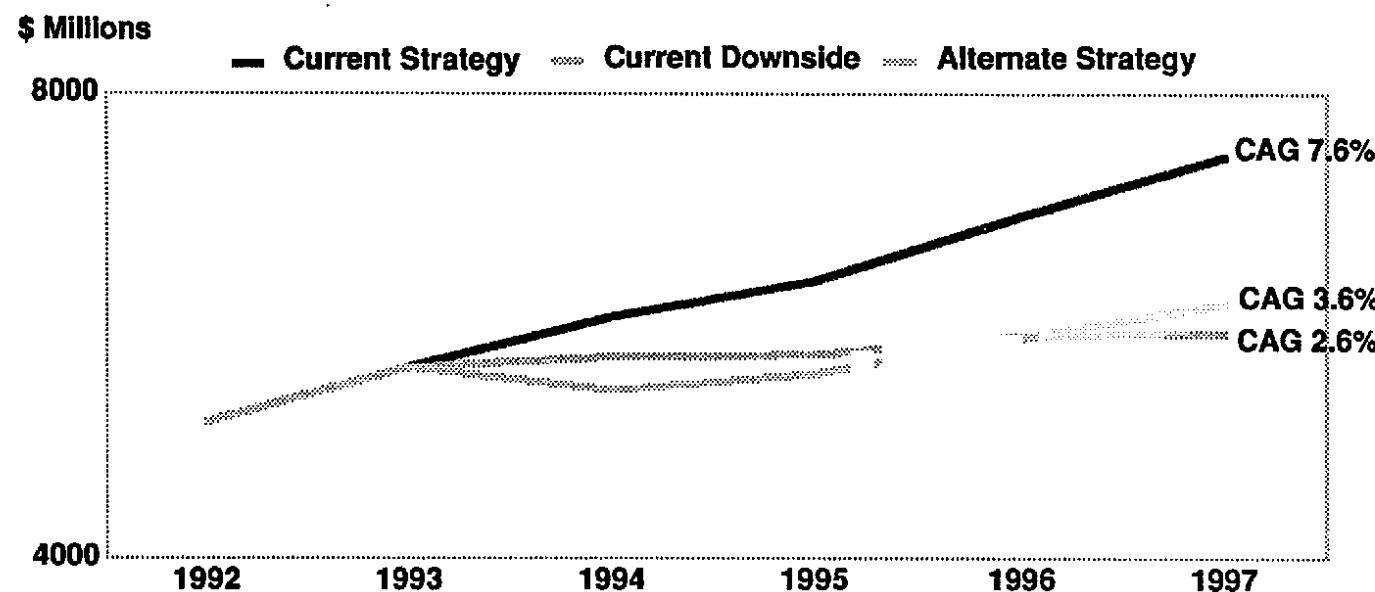
\*\* Off invoice allowance increased \$4.00/thous

\*\*\* Branded Discounts reduced to Value Brand price level Jan. 1, 1994

**PM-USA**  
1993 97 FYP Pres 2/10/93 #2

2073445557

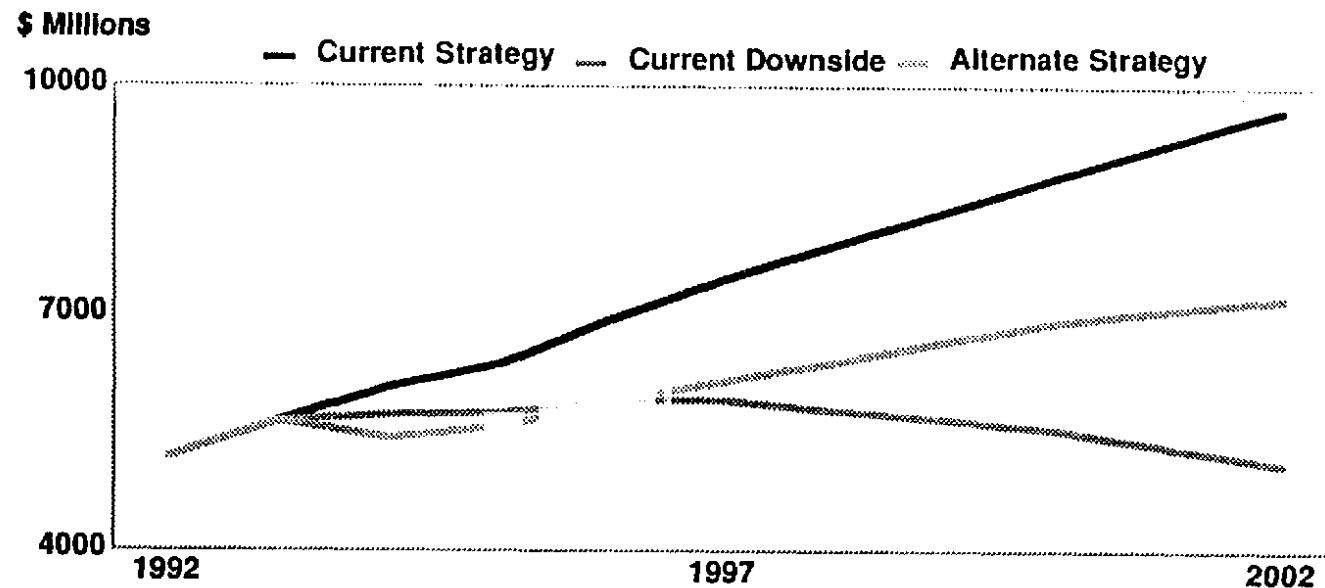
# PM-USA IFO Comparisons



**PM-USA**  
1993-97 FYP #5

2073445558

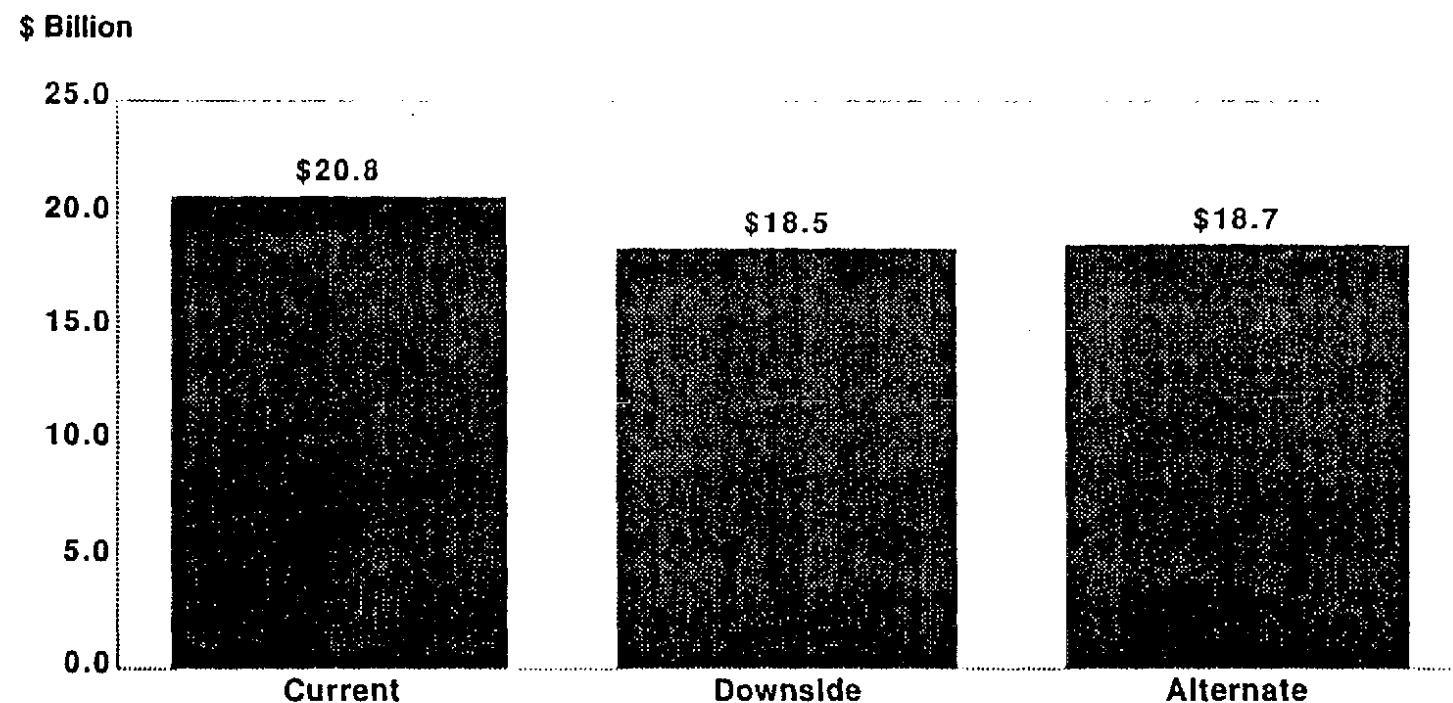
# PM-USA IFO Comparisons 1992-2002



20734559

**PM-USA**  
1993-97 FYP #5

## 1993-97 Cumulative Cash Flow



2073445560

**PM-USA**  
1993-97 FYP Pres. 2/10/93

## 10 Year Scenario Comparison

|                 | <u>Current Strategy</u> |                   | <u>Current Downside</u> |               | <u>Alternate Strategy</u> |               |
|-----------------|-------------------------|-------------------|-------------------------|---------------|---------------------------|---------------|
|                 | <u>2002</u>             | <u>10 Yr. CAG</u> | <u>2002</u>             | <u>10 Yr.</u> | <u>2002</u>               | <u>10 Yr.</u> |
| Industry Volume | 382                     | -2.7%             | 382                     | -2.7%         | 382                       | -2.7%         |
| Premium         | 163                     | -7.4%             | 56                      | -16.8%        | 50                        | -17.8%        |
| Value Brands    | 24                      | -10.9%            | 0                       | --            | 94                        | 2.0%          |
| Deep Discount   | 195                     | +9.9%             | 326                     | +15.7%        | 238                       | 12.1%         |
| PM-USA Volume   | 174                     | -2.1%             | 150                     | -3.5%         | 163                       | -2.7%         |
| Premium         | 104                     | -5.0%             | 42                      | -13.1%        | 36                        | -14.5%        |
| Value Brands    | 5                       | -12.2%            | 0                       | --            | 81                        | 32.1%         |
| Deep Discount   | 65                      | +10.9%            | 108                     | +16.6%        | 46                        | 7.1%          |
| Discount Share  |                         | 57.3%             |                         | 85.3%         |                           | 86.1%         |

**PM-USA**  
1993-97 FYP Pres. 2/10/93 #2

2073445561